APR 15 1976
MICHAEL RODAK, JR., CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1976

No. 75-1492

ROCHEZ BROTHERS, INC.,
a Pennsylvania corporation

vs.

CHARLES R. RHOADES,
Petitioner

No. 74-2209

IN THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

Petition for Writ of Certiorari to the United States Court of Appeals for the Third Circuit

JOHN A. METZ, JR.
3600 Grant Building
Pittsburgh, Pa. 15219
Counsel of Record

ROBERT G. MACALISTER
CHARLES B. WATKINS
1410 Grant Building
Pittsburgh, Pa. 15219
Attorneys for Petitioner

Financial Press Corporation, Pittsburgh

INDEX

	Page
OPINIONS BELOW	1
STATEMENT OF JURISDICTION	2
QUESTION PRESENTED	3
STATUTES INVOLVED	4
STATEMENT OF THE CASE	6
REASONS FOR THE ALLOWANCE OF THE WRIT	9
CONCLUSION	13
APPENDIX A	1a
APPENDIX B	23a
APPENDIX C	52a
APPENDIX D	62a

TABLE OF CITATIONS

Page

CASES

Affiliated Ute Citizens v. United States, 406 U.S. 128 (1971) 9, 12

Janigan v. Taylor, 344 F.2d 781 (CA1, 1965) *cert. denied* 382 U.S. 879 (1965) 9, 11, 12

Myzel v. Fields, 386 F.2d 718 (CA8, 1967) *cert. denied* 390 U.S. 951 (1968) 12

STATUTES

SECURITIES EXCHANGE ACT OF 1934, 15 U.S.C.:

78aa, Section 27 7

78bb(a), Section 28 ..... 5, 9

78j(b), Section 10(b) 4, 6

REGULATIONS

Rule 10b-5 of the SECURITIES AND EXCHANGE COMMISSION, 17 CFR 240 ..... 4, 6-7, 12

To the Honorable, the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Petitioner, Charles R. Rhoades, prays that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Third Circuit entered November 20, 1975 in case No. 74-2209 styled Rochez Bros., Inc., a Pennsylvania corporation, v. Charles R. Rhoades wherein the Third Circuit vacated judgment against petitioner and in favor of Rochez Bros., Inc., a Pennsylvania corporation and remanded for further proceedings.

OPINIONS BELOW

The first opinion of the District Court is found in 353 F. Supp. 795 (Appendix A).

The first opinion of the Court of Appeals and its decision on Motion for Rehearing are found in 491 F. 2d 402 (Appendix B).

The second opinion of the District Court is found in 390 F. Supp. 470 (Appendix C).

The second opinion of the Court of Appeals is found in F.2d (Appendix D).

JURISDICTION

The judgment of the Court of Appeals sought to be reviewed was entered November 20, 1975.

On January 27, 1976 an Order was signed extending the time within which to petition for certiorari to and including April 18, 1976 (No. A-663).

The Court's jurisdiction is invoked under 28 U.S.C. 1254 (1) and 2101 (c).

QUESTION PRESENTED

Under Section 28 of the SECURITIES EXCHANGE ACT OF 1934, 15 U.S.C. 78bb (a), in a non-disclosure case where the defendant received on resale more than the seller's actual loss should not the damages be limited to the seller's actual loss unless the non-disclosure of the resale was a violation of Section 10(b) of the same Act, 15 U.S.C. 78j(b) and Rule 10b-5 of the SECURITIES AND EXCHANGE COMMISSION, 17 CFR 240. 10b-5?

STATUTES INVOLVED

The statutes and regulations which the case involves are:

1) Section 10(b) of the SECURITIES EXCHANGE ACT OF 1934, 15 U.S.C. 78j(b):

> "Sect. 78j. Manipulative and deceptive devices
>
> 'It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> • • •
>
> '(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.' "

2) Rule 10b-5 of the SECURITIES AND EXCHANGE COMMISSION, 17 CFR 240. 10b-5:

> "Rule 10b-5. Employment of Manipulative and Deceptive Devices
>
> 'It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,
>
> '(1) to employ any device, scheme, or artifice to defraud,
>
> '(2) to make any untrue statements of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> '(3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.' "

3) Section 28 of the SECURITES EXCHANGE ACT OF 1934, 15 U.S.C, 78bb (a):

> "(a) The rights and remedies provided by this chapter shall be in addition to any and all other rights and remedies that may exist at law or in equity; but no person permitted to maintain a suit for damages under the provisions of this chapter shall recover through satisfaction of judgment in one or more actions, a total amount in excess of his actual damages on account of the act complained of. Nothing in this chapter shall affect the jurisdiction of the securities commission (or any agency or officer performing like functions) of any State over any security or any person insofar as it does not conflict with the provisions of this chapter or the rules and regulations thereunder".

STATEMENT OF THE CASE

Prior to September 16, 1967 Charles R. Rhoades (Rhoades) the petitioner here, and Rochez Bros., Inc. (Rochez) each owned 50% of the outstanding stock of MS&R, Inc. (MS&R).

On September, 1967 Rhoades made an agreement with Rochez to purchase the latter's 50% of the MS&R stock for $598,000.00 and this sale was closed November 13, 1967.

Prior to September 16, 1967 a business broker named Wingate Royce had brought to Rhoades as prospects for the purchase of all of the MS&R stock Simmonds Precision Products Company (Simmonds) and Carus Chemical Company (Carus).

Prior to the agreement of September 16, 1967 Rhoades did not disclose Simmonds and/or Carus to Rochez as prospects for the MS&R stock.

After acquiring the Rochez 50% of the MS&R stock Rhoades rejected the Simmonds and Carus inquiries.

In the first half of February, 1968 Wingate Royce advised Rochez of the Simmonds and Carus discussions which he had engendered back in 1967.

In April, 1968, through the good offices of Western Pennsylvania National Bank, Rhoades was introduced to Esterline Corporation (Esterline) as a prospective buyer of all the MS&R stock. Negotiations then began and on July 16, 1968 Rhoades and Esterline made an agreement for the sale of the stock by Rhoades to Esterline for $4,250,000.00 cash and 50,000 shares of Esterline restricted stock. This sale was closed July 23, 1968.

On September 11, 1968 this action was instituted to recover damages under Section 10(b) of the SECURITIES EXCHANGE ACT OF 1934, 15 U.S.C. 78j(b) and Rule 10b-5 of

the SECURITIES AND EXCHANGE COMMISSION 17 CFR 240, 10b-5 under which the federal courts have exclusive jurisdiction: SECURITIES EXCHANGE ACT OF 1934, Section 27, 15 U.S.C. 78aa.

At no time before filing the action on September 11, 1968 did Rochez notify Rhoades that Rochez elected to avoid the sale of its MS&R stock to Rhoades because of the latter's non-disclosure of the Simmonds and Carus negotiations.

The District Court, Dumbauld, J., sitting without a jury found that the non-disclosure by Rhoades of the Simmonds and Carus inquiries before September 16, 1967 was a violation of Rule 10b-5 (Appendix A, 14a).

The District Court also held that the measure of damages for the wrongful non-disclosure should be to place Rochez in the same position it would have been in if Rhoades had made appropriate disclosure, i.e., to give Rochez what it would have gotten for its stock if it had known before September 16, 1967 of the interest of Simmonds and Carus as potential purchasers (Appendix A, 16a).

The District Court determined that the value of the Simmonds offer should be the upper limit of the damages (Appendix A, 17a), that if Rhoades had made the disclosure that the Simmonds transaction was pending that deal could have been closed for $2,000,000.00 for all the MS&R stock and that Rochez having sold its 50% for $598,000.00 rather than $1,000,000.00 its damages would be $402,000.00 (Appendix A, 20a).

On appeal by Rochez, the Court of Appeals vacated the judgment, holding that the proper measure of damages was the difference between the value of 50% of the MS&R stock on the basis of the Esterline purchase price in 1968 and the amount Rochez received from Rhoades for its 50% of the

MS&R stock in 1967 (Appendix B, 39a). The order remanded for further proceedings (Appendix B, 42a).

On remand, the District Court held that the judgment against Rhoades should be in the amount of $2,125,000.00 (one-half of the $4,250,000.00 cash paid by Esterline) less $598,000.00 (the sale price paid Rochez by Rhoades) or $1,527,000.00 plus the value of 25,000 shares of the 50,000 restricted shares received by Rhoades from Esterline plus interest from July 23, 1968 the closing date of the Esterline sale (Appendix C, 54a-5a). The value of this stock was fixed at $1,000,000.00 and judgment entered against Rhoades for $2,527,000.00 plus interest (Appendix C, 61a).

On appeal by Rhoades the Court of Appeals vacated the judgment, holding that the 25,000 shares of Esterline stock had been improperly valued at $1,000,000.00 and that the Court would not review the propriety of the $1,527,000.00 balance of the judgment arising out of the cash purchase price of the Esterline sale on the ground that those issues had been decided on the first appeal (Appendix D, 66a and 64a). The case was again remanded for further proceedings (Appendix D, 69a).

Rhoades now petitions for certiorari to review the proceedings thus summarized.

REASONS FOR THE ALLOWANCE OF THE WRIT

The Court of Appeals has decided an important question of federal law which has not been, but should be, settled by this Court.

In *Affiliated Ute Citizens v. United States*, 406 U.S. 128 (1971) 155, this Court encapsulated the measure of damages under Section 28 of the SECURITIES EXCHANGE ACT OF 1934, 15 U.S.C. 78bb (a) as follows:

> "In our view, the correct measure of damages under Sect. 28 of the Act, 15 U.S.C. Sect. 78bb (a), is the difference between the fair value of all that the mixed-blood seller received and the fair value of what he would have received had there been no fraudulent conduct, see Myzel v. Fields, 386 F. 2d 718, 748 (CA8 1967), cert. denied, 390 U.S. 951 (1968), except for the situation where the defendant received more than the seller's actual loss. In the latter case damages are the amount of the defendant's profit. See Janigan v. Taylor, 344 F. 2d 731, 786 (CA 1 1965), cert. denied, 382 U.S. 879 (1965)".

In *Affiliated Ute* the general rule thus stated was applied. It was held that the measure of damages for each seller of the stock involved was the difference between $1,500.00 per share, the fair value at the time of the sales, and what the seller actually received from the buyer (154-156).

The exception delineated by reference to *Janigan v. Taylor*, 344 F. 2d 781 (CA1, 1965) *cert. denied* 382 U.S. 879 (1965) was dictum.

The courts below have applied that dictum as the rule governing the damages in this case.

The facts of the case for which we seek certiorari present a cogent argument why that dictum should be

rejected and now restated as a ratio decidendi in this case. The exception should not apply in a Rule 10b-5 non-disclosure case where the resale on which the defendant received more than the seller's actual loss was not even in the mind's eye of the seller at the time of the sale. Stated conversely, in non-disclosure cases the exception applies only when the non-disclosure of the resale is a violation of Rule 10b-5. Unless the eventual resale is encompassed within the fraudulent non-disclosure, no damages should be meted out for what could not have been disclosed.

If no such limitation is imposed on the generality of the exception then in a case like this, notwithstanding that the seller's actual loss is readily determinable under the general rule, the stock will be left as an untouchable leper which may never be resold or otherwise dealt with for profit. No matter how many years may elapse (absent some possible statute of limitations or laches application) the taint will remain as an embargo on the alienability of the stock.

Whereas, if the limitation *is* imposed then the purpose of the statute and rule are accomplished without fettering the stock.

If Rhoades had had any awareness of the possibility of the Esterline sale when he bought out Rochez in September, 1967 then the rule stated by Judge Dumbauld would provide the remedy as follows:

> "The true measure of damages for the wrongful non-disclosure should be to place plaintiff in the same position it would have been in if Rhoades *had* made appropriate disclosure". (Appendix A, 16a)
>
> (Emphasis by the Court)

This was the remedy which was applied by the District Court when it entered judgment for $402,000.00 based only on the Simmonds and Carus inquiries. It was a remedy

which put Rochez right where it would have been had there been disclosure. Because the Esterline deal did not then exist even in the imagination of Rhoades, it could not have been disclosed. On the other hand, had the Esterline deal then been even incipient, its disclosure would have been required and when it later bore fruit in the form of profits to Rhoades exceeding the Rochez actual loss, Rochez would have been entitled to its share thereof. Clearly this is, therefore, a remedy which compensates the injured seller in such a case for the non-disclosure which Congress by statute and the Securities and Exchange Commission by rule have declared wrongful.

To carry out the intent of the securities laws it is not necessary to render illicit any future profitable traffic in the stock.

Janigan v. Taylor, supra, does not require a different conclusion. There the defendant made a ***positive misrepresentation*** that there had been no material change in the affairs of the company (344 F. 2d at 783). As a result, in early 1956 he bought the stock for $40,000.00. In December, 1957 he resold it for $700,000.00. Suit was brought in October, 1958 (344 F. 2d at 783). Finding that plaintiff had relied on the false representation the court awarded as damages defendant's net profit.

The opinion is silent on the question whether the resale was in any stage of contemplation or conscious possibility on the part of the buyer at the time of the $40,000.00 purchase. If it *was*, then the decision applied the rule as we believe, it should be limited. If it was *not*, then, we think it either goes too far or may be justified on the distinction that it was a case of positive misrepresentation rather than non-disclosure.

Notwithstanding that decision, therefore, we respectfully submit that while the exception stated by this Court by

way of dictum in *Affiliated Ute*, as aforesaid, may be plainly appropriate where the undisclosed resale is immediate or under active contemplation when the fraudulent purchase is made, it is just as plainly wrong when the resale is much later and was not planned at the time of purchase. Under those circumstances, as here, the fair measure of damages is the difference between price and value at the time of the transaction.

In short, the rescissional damage rule of *Janigan* and *Myzel*, recognized as the only exception to the general rule of Rule 10b-5 damages approved by *Affiliated Ute*, requires a limitation in order that that rule of damages not be unnecessarily harsh. The authorities relied on for the *Janigan* and *Myzel* decisions readily reveal the nature and logic for this required restriction. The teaching of the instant case is simply that when a buyer receives on resale of the stock purchased from the seller more than the seller lost, the seller's damages are limited to his actual loss unless the non-disclosure of the resale (unknown even to the buyer at the time of the transaction) violates Rule 10b-5.

CONCLUSION

For the reasons assigned, petitioner prays that its Petition for Writ of Certiorari be granted and that the writ issue to review the decision and judgment of the United States Court of Appeals for the Third Circuit entered in case No. 75-2209 on November 20, 1975.

Respectfully submitted,

JOHN A. METZ, JR.
ROBERT G. MACALISTER
CHARLES B. WATKINS
Attorneys for Petitioner

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA

ROCHEZ BROS. INC.,
a Pennsylvania corporation,
Plaintiff,

v.

CHARLES R. RHOADES, *et al.*
Defendants.

Civil Action
No. 68-1048

OPINION

DUMBAULD, *J*.

This is an action alleging violation of Rule 10b-5 promulgated by the Securities and Exchange Commission. (A claim for fraud under Pennsylvania law is annexed on the theory of pendent jurisdiction.[1]) That rule reads as follows:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person
>
> in connection with the purchase or sale of any security.[2]

---

[1] See *Hurn v. Oursler*, 289 U.S. 238, 246 (1933); *UMWA v. Gibbs*, 383 U.S. 715, 722-27 (1966).

[2] 17 CFR §240.10b-5.

It was originally adopted on May 21, 1942, as Rule X-10B-5, borrowing language from §17(a) of the Securities Act of May 27, 1933[3] and applying it "in connection with the purchase or sale of any security."[4]

The rule was purportedly in pursuance of Section 10(b) of the Securities Exchange Act of June 6, 1934, which provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange . . .
>
> • • • • •
>
> (b) To use or employ in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.[5]

As will be seen in due course, an extensive judicial gloss has encrusted these texts, with the result that "A startling

---

[3] It shall be unlawful for any person in the sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly . . .

(1) to employ any device, scheme, or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser. 48 Stat. 74, 84-85; 15 U.S.C. 77q.

[4] Louis Loss, *Securities Regulation* (2nd ed. 1961), III, 1428-27.

[5] 48 Stat. 881, 891; 15 U.S.C. 78j(b).

variety of everyday transactions have turned out to be 'fraudulent' under SEC Rule 10b-5"[6] The interpretative transmutation has been so extensive that "Rule 10b-5 no longer means what it says. This is a signal failing in any positive law."[7]

The rule was extemporized by two SEC employees who wanted to do something about a Boston executive who was buying up his company's stock by telling the owners that the company was doing badly, whereas in fact the earnings had quadrupled.[8] Thus "the archetypal 10b-5 case is the purchase by one group in a closed corporation of the interest of another, without disclosing negotiations for sale or other disposition of the issuer's assets or its securities at a higher price."[9]

Originally, only administrative enforcement was contemplated. But now it is clear that the seller as well as the buyer may bring a civil action.[10] The pioneer holding to this effect was a decision by the late distinguished Judge Kirkpatrick in *Kardon v. National Gypsum Co.*, 69 F. Supp. 512, 513-14 (E.D. Pa. 1946). It is noteworthy that in this field of the law leadership has been manifested by District Judges (especially in the Southern District of New York) but that the

---

[6] Alan R. Bromberg, *Securities Law: Fraud*, (1967), I, sec. 1.1, p. 3 [1971].

[7] Bromberg, II, sec. 12.9, p. 283.

[8] Bromberg, I, sec. 2.2 (410), (420), pp. 22.6-22.7 [1970]. For the example involved, see Bromberg, II, App. D., pp. 305-13.

[9] Bromberg, I, sec. 4.2, p. 70.

[10] Bromberg, I, sec. 2.2 (333), p. 22.4 [1970]; *S.E.C. v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 867, 884 (C.A. 2, 1968); *Mutual Shares Corp. v. Genesco, Inc.*, 384 F.2d 540, 543 (C.A. 2, 1967); *Royal Air Properties v. Smith*, 312 F.2d 210, 212-14 (C.A. 9, 1962); *Northern Trust Co. v. Essaness Theatres Corp.*, 103 F. Supp. 954, 965 (N.D. Ill. E.D. 1952); *Fischman v. Raytheon Mfg. Co.* 188 F.2d 783, 787 (C.A. 2, 1951); *Slavin v. Germantown Fire Ins. Co.*, 174 F.2d 799, 805, 814 (C.A. 3, 1949).

Supreme Court has made few pronouncements on the subject.[11]

It is clear that mere mismanagement or violation of a fiduciary duty under state corporation law does not violate the rule.[12] There must be use, "in connection with the purchase or sale" of a security, of information, accessible to a corporate "insider" for limited fiduciary purposes, but used instead for personal economic advantage, to the detriment of a party to the transaction not having access to such information.[13] The information must be such as would have influenced the uninformed party's decision with respect to the transaction.[14] Information equally accessible to both parties, or which the other party in fact knows or should have known, need not be disclosed.[15] Mere speculations or

[11] Bromberg, II, Sec. 12.1 p. 266; *S.E.C. v. National Securities, Inc.*, 393 U.S. 453, 465 (1969). An interesting case involving Rule 10b-5 in the context of proxy materials was recently decided by the Court of Appeals for the Third Circuit, *Kohn v. American Metal Climax, Inc.*, 458 F.2d 255 (C.A. 3, 1972).

[12] *Supt. of Insurance v. Bankers Life & Casualty Co.*, 404 U.S. 6, 12 (1971); *Mutual Shares Corp. v. Genesco., Inc.* 384 F.2d 540, 545 (C.A. 2, 1967); *O'Neill v. Maytag*, 339 F.2d 764, 767-8 (C.A. 2, 1964); Bromberg, I, sec. 4.7, pp. 83-88.2 [1968].

[13] *Speed v. Transamerica Corp.*, 99 F. Supp. 808, 828-29 (D. Del. 1951) [approved in 235 F.2d 369, 373 (C.A. 3, 1956)]; *Kohler v. Kohler Co.*, 319 F.2d 634, 637-38, 642 (C.A. 7, 1963); *S.E.C. v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 848 (C.A. 2, 1968); *Schine v. Schine*, 250 F. Supp. 822, 824, 828 (S.D. N.Y. 1966).

[14] *List v. Fashion Park*, 340 F.2d 457, 462-63 (C.A. 2, 1965). This case is the subject of a good annotation on "Corporate Insider's Non-disclosure of Information to Seller or Purchaser of Corporation's Stock as Manipulative or Deceptive Device Prohibited by §10(b)" in 22 ALR 3d 793-807. See also *Rogen v. Ilikon Corp.*, 361 F.2d 260, 266-67 (C.A. 1, 1966); and *Janigan v. Taylor*, 344 F.2d 781, 785 (C.A. 1, 1965); *Reed v. Riddle Airlines*, 266 F.2d 314, 315 (C.A. 5, 1959).

[15] *Myzel v. Fields*, 386 F.2d 718, 736 (1967); Bromberg, II, sec. 8.4 (651)(1).

opinions as to present value or future earnings do not constitute violations, as such differences are the life of the stock market as well as of horse races, and parties are relegated to their own judgment in such matters; but an opinion insincerely professed can have the consequences of a misstatement of fact,[16] since the state of a person's mind is as much a fact as the state of his digestion, as an English judge once remarked.[17]

In applying the foregoing body of judicially created legal precepts, in order to determine whether plaintiff has established a violation of Rule 10b-5 by defendant, it will be necessary to scrutinize the facts developed in the record, during 18 trial days.

This case arises out of the business activities of defendant Charles R. Rhoades, whose blunt staccato speech resembles that of a military officer, and who is said to be a hard-driving executive. (Tr. 1604-1605). He is of litigious disposition and also has a special aptitude for dissension with his business associates. (Tr. 1679, 1694-95). When evicted from his office with Mason, Shaver, and Rhoades he occupied space in plaintiff's office. (Tr. 23-25). Later an arrangement was made whereby plaintiff and defendant each acquired half ownership of the stock of that company, and the name was changed to MS&R Inc. Plaintiff paid

[16] Bromberg, I, sec. 5.3, p. 97. "The mere fact that a forecast is inaccurate does not make it fraudulent, and a margin for error is recognized." *Ibid.*, p. 98, citing *S.E.C. v. R. A. Holman & Co.*, 366 F.2d 456, 457-58 (C.A. 2, 1966). According to the annotation in 22 ALR 3d 793, 797: "mere expectations or hopes are not material facts, even if they materialize later, but . . . nondisclosure of events which had occurred already or the happening of which had been definitely decided upon is a material fact if it can be shown to have had an effect on the decision of the other party to the transaction, acting as a reasonable person." See also *Kohler v. Kohler Co.*, 319 F.2d 634, 640 (C.A. 7, 1963).

[17] Lord Bowen in *Edgington v. Fitzmaurice*, 29 Ch. D. 459, 483 (188[illegible]).

$272,500 for its share on July 1, 1964 (Tr. 30-31). Rhoades was president and director of the company, Joseph Rochez (president of plaintiff) was vice president and director, and George MacClaran, of Pittsburgh National Bank, was the third director. (Tr. 31-32).

Rhoades was a sanguine plunger and promoter, a salesman type. Rochez was shrewd and suave, a financier type. (Tr. 1794). Rhoades would occasionally book business and get a disproportionate advance in progress payments from the customer to carry the expenses arising out of performance of the contract. (Tr. 176-78). Rochez complained of lack of working capital, and disfavored overextension. But he was unwilling for plaintiff to supply unilaterally the needed capital (except for small urgent needs), and Rhoades was unwilling or unable to furnish his share (Tr. 43, 47). A contract with Babcock & Wilcox was one of the chief bones of contention. This was a large order which required considerable expense on the part of MS&R for equipment and materials in order to perform the contract. (Tr. 1336-39). Rochez vigorously opposed taking on the contract, and upon learning that counsel considered the contract to be binding, he caused his protest to be entered in the minutes for his protection as a director. (DX 15 and 16, Tr. 155-57, 306-307).

Rhoades regarded the contract as the opening wedge to future profitable business and declared he would personally undertake the commitment if MS&R declined it (DX-97). At a directors' meeting of September 8, 1967, Western Pennsylvania National Bank (WPNB) undertook to make loans of $600,000 to MS&R, with an unsecured line of credit of $200,000, replacing Pittsburgh National Bank (PNB) as the company's lender. After some controversy, the resignation of MacClaran as a director was accepted (DX-98). No further meetings were held until after the sale of Rochez stock to Rhoades.

On May 2, 1965, plaintiff moved its offices into the MS&R premises and consolidated accounting continued until April 30, 1967, when separate accounting was resumed and physical removal of plaintiff's employees took place on August 19, 1967.

The dissension was such that both Rochez and Rhoades interviewed prospective purchasers of the company. They also discussed a buy-sell agreement whereby one of them would buy out the other's interest. (A restriction prevented sale to outsiders without first offering it to the other stockholder. DX-4, Tr. 1693).

In pursuance of this plan plaintiff finally named the price for which it was willing to sell its stock to defendant. On September 16, 1967, an agreement of sale was executed, under which Rhoades bought plaintiff's stock for $598,000 (PX-9). The closing and delivery of the stock certificates to defendant, took place on November 13, 1967 (Tr. 92).

When plaintiff on September 11, 1967, stated its terms, one of them was that the deal should be concluded by noon on September 15th, and that Rhoades should put $50,000 in escrow, to be forfeited if the closing did not take place on September 29th.[18] (DX-56). Rhoades borrowed that sum from WPNB, and later borrowed the remainder of the purchase price from the same bank. His well-to-do cousin Edward C. McCormick, Jr., would have furnished the money to pay for the Rochez stock if Rhoades had been unable to borrow it from the bank. (Tr. 1533-35, 1675).

It is fair to assume that Rochez knew that Rhoades would have to borrow the money from a bank or "from other

---

[18] Tr. 1895-97. By agreement, the time for closing was later extended to December 12th (Tr. 380). Plaintiff's haste to close the deal may be taken into consideration in determining the appropriate scope of disclosure. *Kohler v. Kohler Co.*, 319 F.2d 634, 638, 642 (C.A. 7).

investors that he may have had in the wings." Plaintiff did not care where the money came from "as long as we got our price." (Tr. 385-86).

In February of 1968 Joseph Rochez received a phone call from one Wingate Royce, who claimed that Rhoades had employed him to find a purchaser for MS&R, that Royce had found a ready, willing, and able purchaser, and had earned his commission or finder's fee, but that Rhoades would not go through with the deal or pay (Tr. 96-97). Royce in fact sued Rhoades; Rhoades paid Royce some money under some other pretext without admitting liability; and the suit was withdrawn (Tr. 1702-1704).

From the tale unfolded to him by Royce, Rochez obtained documents and information which led to the present litigation (Tr. 101).

It is now clear that in fact Rhoades did answer an advertisement and Royce visited the MS&R plant on April 21, 1967, and was introduced by Rhoades to Rochez. Rochez disdained hiring Royce to find a purchaser for MS&R, but on that very day Rhoades signed a letter to Royce employing him to find a purchaser. (PX-3)

Thereafter, in April of 1967, Royce brought MS&R as a potential acquisition to the attention of J. Walter English, of Simmonds Precision Products Co. (Tr. 1150). In May of 1967 English visited MS&R (Tr. 860-62, 1151) after Royce had informed Rhoades that Simmonds was a possible purchaser. According to Rhoades, he told Royce *ex industria* that he was not interested in acquisition discussions, but agreed to see English as a possible customer for MS&R products (Tr. 1686-88). However, the testimony of English shows that Simmonds was interested in the prospect of acquiring MS&R (Tr. 1150-51); and that Rhoades knew it.

In late August or early September, 1967, Rhoades and Wendell E. Hager (his production assistant) visited a Simmonds plant near Hartford and dined with Simmonds personnel. On the return trip to Pittsburgh they rode with Geoffrey Simmonds in the latter's company plane. Simmonds toured the MS&R plant en route to a further destination. Upon arrival at the Hartford airport Rhoades telephoned his Pittsburgh attorney's office to learn how the buy-sell negotiations with plaintiff were progressing. (Tr. 1296, 1298, 1303-1306, 1722-27). Rhoades maintains, unconvincingly, that these contacts had nothing to do with acquisition of MS&R.

Another improbable story is the version given by Rhoades of his dealings with Carus Chemical Company. Though admitting that Royce had informed him of the interest of Carus in acquiring MS&R stock, he insists that visits of the Carus brothers to the MS&R plant were merely to look at the computer system employed by MS&R (Tr. 1689-92). This used a standard IBM computer (Tr. 1709). Royce was adviser on acquisitions for the Carus Company, and (to avoid conflict of interests) would have taken no commission from Rhoades if the sale of MS&R had been made to Carus (Tr. 591). The visit by the Carus brothers took place in the latter part of August, 1967 (Tr. 1705). At that time they told Rhoades Carus would be interested in purchasing MS&R stock (Tr. 1708).

Perhaps somewhat like the layman's view that a contract written in lead pencil is not binding, or the ostentatious ostracism by a corporate sales manager of his opposite number in a competitor firm while they are sitting in the grand jury anteroom waiting to testify in an anti-trust investigation, is the attitude assumed by Rhoades with respect to acquisition negotiations. He seemed to think that newsworthy events ceased to exist upon his disclaimer of

interest in them. Although the potential purchasers expressed interest in MS&R, Rhoades considered their interest as non-existent because he had obtained offers of financial support from his cousin and did not need to follow up the leads unearthed by Royce (Tr. 1686, 1708). Nevertheless, the fact that such interest existed on the part of potential purchasers would certainly be a factor affecting the value of MS&R stock in the mind of a reasonable man, and hence a matter required to be disclosed under Rule 10b-5. (See note 14 *supra*). This was not the type of information available from the company books and records. The financial sophistication of Joseph Rochez would be of no avail in the absence of such knowledge.[19] With respect to such matters, although an "insider" by virtue of his position in MS&R, Rochez would be an "outsider."

Upon conclusion of the agreement of September 16, 1967, for the purchase of the Rochez stock, Rhoades considered himself the complete owner of the company. After that date he felt no duty to disclose anything to plaintiff, but did not base this view on any specific advice of counsel (Tr. 1714, 1747-48). He promptly began earnest and diligent efforts to dispose of MS&R. On September 18, 1967, he telephoned both Simmonds and Carus (Tr. 1735). The Carus offer was unattractive to Rhoades as it in substance would have required him to earn the purchase price himself out of future profits (Tr. 555-56, 888, 1697-98). The Simmonds offer fell through both because it was unattractive taxwise to Rhoades, and because Simmonds did not wish to become involved in a possible lawsuit with the Rochez interests (Tr. 1181-3, 1188-89, 1199-1200, 1453-54, 1742-43, 1815). The Simmonds offer contemplated exchange

[19] As Justice Brandeis insisted, "knowledge is the basis of wise business action." Alpheus T. Mason, *Brandeis: A Free Man's Life* (1946) 123. No opinion can be any better than the facts upon which it is based.

of restricted ("lettered") stock of Simmonds for MS&R stock (Tr. 874, 1659).

In April of 1968, through the good offices of WPNB, Rhoades began negotiations with Esterline Corporation (Tr. 625-26), which were consummated by a formal agreement of July 16, 1968 (PX-22). Besides an employment contract (Tr. 1799), Rhoades (and two others to whom he had sold some MS&R stock) received $4,250,000 in cash together with 50,000 shares of Esterline restricted stock (Tr. 1241-42, 1770, 1773).

In view of the foregoing facts, showing non-disclosure of material information by defendant (with respect to the Simmonds and Carus dealings) before September 16, 1967, it is not necessary to determine the validity of defendant's contention that September 16, 1967, rather than November 13, 1967, is the critical date. If it were necessary to decide, we would be inclined to follow *Radiation Dynamics v. Goldmuntz*, 464 F.2d 876, 890-91 (C.A. 2, 1972).

While it is true that Rule 10b-5 speaks broadly of fraud "in connection with" the purchase or sale of any security, and events even after the date of transfer of the certificates might well be relevant to demonstrate fraud in the transaction,[20] and it is also true that the date of transfer would be controlling in a case for recapture of short-swing profits,[21] it seems common sense to treat the binding commitment to sell with some degree of finality. Theoretically, a nice conflict of maxims might require evaluation: the rule that equity regards as done that which ought to be done, on the one hand, and, on the other, the "bad man" theory of Justice

[20] See *Strong v. Repide*, 213 U.S. 419, 433 (1909). Hence, defendant's oft-repeated and standing objection to all evidence of events after September 16, 1972, was properly overruled.

[21] As in *Brenner v. Career Academy*, 467 F.2d 1080, 1084-85 (C.A. 7, 1972).

Holmes[22] that would regard the obligation of a contract as merely the liability to pay damages for its breach, which might well be less than the profitability of non-performance.

It is also unnecessary, in the view we take of the case, to attribute the weight which plaintiff does to defendant's failure to furnish to plaintiff certain financial forecasts prepared by defendant. It is true that many business men have developed through experience and training an extreme precision in their ability to predict with accuracy the results of business operations. Nevertheless, on the whole, such anticipations lack the certitude of historical fact. Many a slip can occur betwixt cup and lip. Expectations, rather than accomplishments, are recorded in such figures.[23]

The testimony here discloses that the use of such financial tools as an aid to management was better known to plaintiff than to defendant. Defendant first saw such a forecast on the desk of Harold E. Cline, an employee of plaintiff. He regarded this forecast as too pessimistic, and made changes in it, which he submitted to plaintiff (Tr. 924-25, 1019-21). Thereafter defendant prepared other similar documents, which reflected various assumptions and hypotheses which he envisaged. Apart from his own instruction and amusement, defendant used these "optimistic" forecasts as sales propaganda and furnished them to bankers from whom he was seeking to borrow and to prospective purchasers of the company's stock. He admitted that they were "optimistic" rather than "conservative" predictions.

---

[22] Holmes, *Collected Legal Papers* (1920) 173-75. See also Moorfield Storey, *The Reform of Legal Procedure* (1911) 32-33.

[23] The fallibility of forecasting is emphasized in two recent discussions: Bruce D. Henderson, "Generally Accepted Forecasting Principles," Harvard Law School Record, Dec. 1, 1972, p. 14; and William C. Norby, "Fair Play in Earnings Forecasts," New York Times, Dec. 31, 1972, sec. 3, p. 12.

That defendant was more rosy in his views of the prospects of MS&R than was Joseph Rochez is a notorious fact. Rochez was shocked to hear Rhoades name a high figure as the value of the company when talking on the phone to a prospective purchaser (Tr. 256-57). Rochez was much more conservative and down to earth in his appraisal of the company's condition. He was much more concerned than Rhoades over the need of money to pay bills as they came due, and of compliance with the company's obligations to its bank. At board meetings Rhoades enunciated optimistic views which Rochez scorned. We are unable to believe that if Rhoades had communicated these optimistic forecasts to Rochez the latter would have viewed them other than with his customary "incredulity" or would have put any credence in them or relied upon them in determining the price to ask for plaintiff's stock.[24]

Moreover, with respect to figures relating to the company's affairs and ascertainable from the company's books, we find that plaintiff could and should and did rely on its own determinations rather than any representations by Rhoades.[25] Cline, a Rochez employee, was titular and also active head of the MS&R accounting department (Tr. 1032,

---

[24] Cf. Tr. 152-53, 165. According to one of my favorite quotations from the late Justice Robert H. Jackson, "success depends on knowing what not to believe in accounting." *F.P.C. v. Hope Natural Gas Co.*, 320 U.S. 591, 644 (1944). Joseph Rochez is successful in business; his skeptical attitude towards figures furnished by Rhoades (and doubtless many other parties with whom he has had dealings during the course of his career) is probably a "substantial factor" if not the "proximate cause" of his success.

[25] It is true that a situation resembling that in *Janigan v. Taylor*, 344 F.2d 781, 783 (C.A. 1, 1965), arose at a board meeting on July 7, 1967 when "Mr. Rochez pointed out that no projection of sales and cash flow had been made and he felt it should be done. Mr. Rhoades objected stating the latest projection that was made in December, 1966 remains unchanged and the forecast therein is correct as far as could be expected under present conditions." DX-97.

1558, 1583-84, 1591-94). After the separation of accounting functions, checks were sent for signature to plaintiff, and had to be accompanied with supporting data regarding the company's bank account (Tr. 981-83; DX-76). There is no testimony that defendant siphoned off company income into other accounts or that the company's books were "doctored" in any way. Nothing except bad feelings and the distastefulness of contacts with Rhoades and employees loyal to him kept plaintiff from learning anything it wished to know about the affairs of MS&R.

Taking the view we do that defendant's non-disclosure prior to September 16, 1967, and nothing else done by defendant, constituted "fraud" in violation of Rule 10b-5, we are confronted with the problem of determining the measure of damages sustained by plaintiff.

At one extreme, defendant could contend that defendant's wrongful conduct was *functus officio*, and had fully spent its effects, when the Simmonds and Carus negotiations proved abortive; and that hence the damages were *nil*. On the other hand, plaintiff could contend that it is entitled to its equal moiety of the entire "take" or proceeds received by defendant in the Esterline deal. On principle we prefer plaintiff's position, for the reasons stated in *Janigan v. Taylor*, 344 F.2d 781, 786 (C.A. 1, 1965). The court there said that where property is sold to the fraudulent party

> future accretions not foreseeable at the time of the transfer even on the true facts, and hence speculative, are subject to another factor, viz., that they accrued to the fraudulent party. It may, as in the case at bar, be entirely speculative whether, had plaintiffs not sold, the series of fortunate occurrences would have happened in the same way, and to their same profit. However, there can be no speculation but that the defendant actually made the profit and, once it is found that he acquired

> the property by fraud, that the profit was the proximate consequence of the fraud, whether foreseeable or not. It is more appropriate to give the defrauded party the benefit even of windfalls than to let the fraudulent party keep them.

It would not be fair or just, however, to extend this rule to its utmost limits. It must be applied with appropriate *temperamenta* (as the great jurist Grotius said of the strict rights of war.)[28]

Viewed realistically, much of the value for which Rhoades was paid by Esterline did not exist, and could not have existed, so long as Rochez remained half owner of MS&R. Much of this value was created by the enterprising labors of Rhoades, undeterred by the prudent diffidence of his associate Rochez. The importance of the aggressive management contributed by Rhoades is attested to by the fact that Esterline as well as other potential purchasers of MS&R bargained for the continuance of Rhoades under the new ownership (Tr. 564, 589). The Babcock & Wilcox contract, which Rhoades obtained and Rochez stoutly opposed at all times, turned out in fact to be the key, not to Pandora's box, but to much future business and profits for MS&R (Tr. 1338-39).

The fact is that MS&R was in a situation where its value could be increased by an expansion of its business, upon an adequate financial basis (Tr. 698). There was no chance for the creation of such a basis so long as the Rochez-Rhoades ownership continued. Rhoades was unable or unwilling to "ante up" his share of the needed capital, and Rochez rightly refused to bear the entire burden. Salvation lay in uniting the complete control of the company under good management in the hands of an adequately capitalized owner. As soon as

---

[28] See Dumbauld, *The Life and Legal Writings of Hugo Grotius* (1969) 70.

such a buyer was found for 100 per cent of its stock, the value of MS&R stock increased *eo instanti* and *ipso facto*. When plaintiff sold its half, it was not worth much if anything more than what plaintiff received for it. It increased in value when the dissension between the joint owners and the chronic underfinancing terminated upon takeover by a new and strong owner (Tr. 802).

So long as Rochez and Rhoades were equal owners, there was little hope of successful operation. They were in the position of the two men in the allegorical story of heaven and hell who found themselves confronting a delectable feast, but unable to bend their elbows so as to bring the food to their mouths. They turned their situation from a hellish to a heavenly one by cooperating and feeding each other. Rochez and Rhoades could not achieve this solution. A destructive deadlock was destined to continue so long as the two half-owners continued to hold their stock.[27]

Hence it would be unjust to award Rochez the full value of the amount realized by Rhoades, to which Rhoades himself had partly contributed by his aggressive and enterprising management ability, and which was also partly due to the exit of Rochez and to the injection of a new and financially strong owner of undivided control.

The true measure of damages for the wrongful non-disclosure should be to place plaintiff in the same position it would have been in if Rhoades *had* made appropriate disclosure. What would Rochez have gotten for his stock if he had known before September 16, 1967, of the interest of Simmonds and Carus as potential purchasers?

[27] A classical case of the evils of equal ownership is the prolonged plight of Panagra Airlines. *Pan American World Airways v. U.S.*, 371 U.S. 296, 298, 327-28 (1963). The third director of MS&R, Maclaren of PNB, was acutely conscious of the fatal effects of the dissension between Rhoades and Rochez (Tr. 700).

We think that the value of the Simmonds offer should be the upper limit of plaintiff's damages. Rhoades contends that tax reasons led to the frustration of that deal, but the testimony of the Simmonds officials indicates that what really caused them to abandon the transaction was their unwillingness to assume any potential liability to plaintiff arising out of defendant's non-disclosure to the Rochez interests. We accept this evidence, and believe that if this hurdle had not existed, the able counsel involved in the matter would surely have been able to devise an acceptable solution to the tax problems involved. And of course there would have been no such hurdle if defendant had made the disclosure that the Simmonds transaction was pending. We believe that Rhoades would then have had the aid of Rochez as a suave and habile negotiator in helping to complete the Simmonds deal, and that it could have been successfully consummated.[28]

We are confronted with further uncertainties and confusion in attempting to determine the value of the Simmonds offer. Plaintiff's calculation is of course excessive, in attributing to the restricted stock offered by Simmonds the prevailing market value of unrestricted Simmonds stock. But the record contains little, if any, evidence of financial experts as to what the appropriate discount factor would be, in the instant situation, to allow for the disabilities inherent in stock subject to such restrictions.

The terms of the Simmonds offers are described in exhibits PX-12 through PX-24. According to PX-12, a letter from Simmonds to Rhoades dated September 29, 1967, the

[28] Of course it is possible, as defendant contends, (Tr. 586-87): that plaintiff from a dog-in-the manger antipathy to defendant would have rejected *ipso facto* any deal originated by Rhoades. But we believe that self-interest would have prevailed over sentiment and that Rochez would have contributed to consummation of a deal with Simmonds.

basic consideration was estimated at $2,850,000, based on 9.2 times projected net earnings for the period October 1, 1966, to September 30, 1967, to be adjusted when audited figures were obtained. $650,000 was to be in convertible preferred stock with coupon equal to prevailing interest rates. The rest was to be common stock, with a bonus for performance the following year.

PX-15, dated November 17, 1967, raised the preferred to $750,000 and fixed the coupon at 6 per cent. PX-16, the auditor's report for year ended June 30, 1967, showed earnings of $269,343 (as contrasted with the $306,000 figure assumed in PX-12). PX-17, of December 19, 1967, approved by Rhoades, raised the common shares to 120,000 from the 110,000 of PX-15. The preferred was to be 20,000 shares valued at $55 per share.

PX-19A was a formal agreement prepared by defendant's tax counsel, Robert G. MacAlister, as a so-called "B" reorganization under 26 U.S.C. 368(a)(1)(B). It provided for 7,000 shares of preferred with $5 par value, and an unfilled blank number of shares of common at 25 par value. Recitals showed 2,604,084 outstanding shares of Simmonds common stock. Another recital provided that the stock delivered was to be unrestricted and fully listed on the American Stock Exchange. However, later provisions in Section 8 of the draft agreement contemplated registration of only 35,000 shares within 120 days. For other sales registration would be effected after a period of one year. Section 6.4 required an investment letter from Rhoades and the affixing of a restrictive legend to the certificates.

PX-19B (prepared by Simmonds counsel as a "C" reorganization, Tr. 1474-75) contemplates acquisition of MS&R assets by a new subsidiary of Simmonds in exchange for 120,000 shares of Simmonds common stock with par value of 25 cents a share, and 20,000 shares of preferred with

par value of $5 a share. Restrictive provisions are the same as in PX-19A.

PX-20, the auditor's report for six months ending December 31, 1967, shows earnings of $435,376, including retained earnings, the actual net operating income being $166,033. The net income shown in PX-16 was $188,896.

Little light is to be found regarding the valuation of restricted stock, although the technique of disposal of such stock has been discussed.[28] Obviously a number of factors require consideration. These would include the length of the period of restriction, the amount of new and old stock, the customary volume of transactions, the frequency and amplitude of anticipated fluctuations in the market, and the underlying trend based upon intrinsic factors. In a conglomerate acquisition which might temporarily enhance the buyer's stock, a subsequent fall might be anticipated after the promoters had unloaded some of their pre-existing stock without the depressing effect of sales of the newly-issued stock. The effect of the restriction might well be considered a substantial factor calling for considerable discount in determining the value of restricted stock.

In a sense, the very fact that issuers impose a restriction on transferability is an indication of their recognition of the speculative and unstable quality of the stock. Restraints on alienation have long been viewed with disfavor.[30] That Simmonds stock was subject to fluctuation is shown by the

---

[28] Robert S. Green, "Selling Restricted Securities under Rule 144 - A Practical Guide", 18 The Practical Lawyer 13 (May, 1972); "Resale of Restricted Securities under SEC Rule 144", 81 Yale L. J. 1574 (July, 1972).

[30] See the classical treatise of John Chipman Gray, *Restraints on Alienation* (2nd ed. 1895) as well as recent antitrust cases such as *White Motor Co. v. U.S.*, 372 U.S. 253, 256 (1963); *U.S. v. Arnold, Schwinn & Co.*, 388 U.S. 365, 378 (1967).

fact, of which we may take judicial notice, that its range in 1972 was between 4⅛ and 7⅞,[31] whereas during the last quarter of 1967 it sold between 37 and 25 (PX-34 and 35).

In view of the foregoing considerations, and recognizing that our conclusion is arbitrary[32] in the statistical (rather than the constitutional) sense, we find that with plaintiff's cooperation under proper disclosure by defendant, the sum of $2,000,000 could have been obtained for the MS&R stock. Having sold for $598,000 rather than $1,000,000, plaintiff's damages therefore amount to $402,000.

In conclusion, a word should be said regarding the sufficiency of the proof regarding the quasi-jurisdictional matter of use of interstate instrumentalities.

Although from a substantive standpoint this seems a triviality, yet as the statute and Rule 10b-5 are worded,[33] the use of interstate instrumentalities is an indispensable factor

[31] New York Times, Jan. 7, 1973.

[32] By "arbitrary" we mean a rough rule of thumb representing an approximation approaching an actual but uncertain amount, such as the "arbitraries" added in computing freight rates for ferriage, wharfage, and other accessory services; or the "standard deduction" or sales tax tables used in income tax computations, or the deductions for entertainment formerly allowed under the "Cohan rule." See Rabkin & Johnson, *Federal Income, Gift and Estate Taxation*, Vol. I, §3.01 p. 303; *Cohan v. Commr. of Int. Revenue*, 39 F.2d 540, 543-44 (C.C.A. 2, 1930). In the words of the inimitable Learned Hand "It is not fatal that the result will inevitably be speculative; many important decisions must be such." 39 F.2d at 544. See also *Eastman Kodak Co. v. Southern Photo Materials Co.*, 273 U.S. 359, 378-79 (1927). In the constitutional sense, of course, "arbitrary" means tyrannical, oppressive, and violative of due process.

[33] See Bromberg, II, sec. 11.2, pp. 245-46 [1968]. This wording was doubtless adopted in order to satisfy the strict standards then applicable to the definition of interstate commerce and the extent of federal power with respect thereto under decisions of the Supreme Court under the "Nine Old Men." See Dumbauld, *The Bill of Rights and What It Means Today* (1957) 65-66. Such scruples would be superflous since *U.S. v. Darby*, 312 U.S. 100, 113-15 (1941), and *Wickard v. Filburn*, 317 U.S. 111, 121 (1942).

in establishing a wrongful non-disclosure or other violation of the Rule.

Such use of interstate instrumentalities has been adequately established, in our judgment, even assuming that the use of such instrumentalities must be as a means of effectuating or directly connected with the substantively wrongful act (*animo rem sibi habendi*, so to speak) and not as an isolated incident; and confining such use to the period prior to September 16, 1967. Defendant's own testimony established interstate telephone calls and air travel (Tr. 862-64, 1672-73, 1686-88, 1717, 1719, 1722-26). The mere fact that the owners of the stock lived in the Pittsburgh area and that perhaps the most crucial negotiations for the sale from plaintiff to defendant took place in that city[34] does not detract from the sufficiency of the clear showing of use of interstate facilities as a means of wrongfully violating the requirements of Rule 10b-5.

Accordingly, we enter judgment for plaintiff and against defendant in the amount of $402,000 with interest from September 16, 1967. This opinion shall be deemed to constitute the Court's findings of fact and conclusions of law. Because of the thoroughness and excellence of the proposed findings and conclusions submitted by counsel for both parties, we have ordered them to be filed as part of the record, for the convenience of reviewing courts in the event that the reasoning of this Court is found to be a deficient appraisal of the realities captured in the record.[35]

[34] Use of the mails was undoubtedly involved even in these negotiations themselves. Tr. 87.

[35] A former law clerk of Justice Brandeis states that the Justice always wrote himself the statement of facts in an opinion. "This was his assurance that he would not be seduced by the fascination of legal analysis until he had grounded himself in the realities of the case as they were captured in the record." Paul A. Freund, *On Understanding the Supreme Court* (1949) 50.

JUDGMENT

AND Now, this 22nd day of January, 1973, for the reasons set forth in the foregoing opinion, judgment is entered for plaintiff Rochez Brothers, Inc., and against Defendant Charles A. Rhoades in the amount of $402,000.00 with interest from September 16, 1967.

../s/ EDWARD DUMBAULD..
United States District Judge

Copies to:

RALPH GERMAN, Esquire
1330 Oliver Bldg.
Pittsburgh, Pa. 15222

GREGORY KERR, Esquire
10th Floor, Porter Building
Pittsburgh, Pa. 15219

EDMUND S. RUFFIN, Esquire
2900 Grant Building
Pittsburgh, Pa. 15219

UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

Nos. 73-1257 and 73-1258

ROCHEZ, BROS., INC., a Pennsylvania Corporation

v.

CHARLES R. RHOADES, and M S & R INC.,
a Pennsylvania Corporation

ROCHEZ, BROS., INC., a Pennsylvania Corporation, *Appellant in No. 73-1257*

CHARLES R. RHOADES, *Appellant in No. 73-1258*

(D. C. Civil Action No. 68-1048)

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF PENNSYLVANIA

Argued October 12, 1973

Before HASTIE, VAN DUSEN and ADAMS,*
Circuit Judges

OPINION OF THE COURT

(Filed December 21, 1973)

VAN DUSEN, *Circuit Judge*.

In these appeals both parties seek reversal of district court orders granting judgment with damages against an individual defendant, Charles R. Rhoades, in an action under section 10(b) of the Securities Exchange Act of 1934,

15 U.S.C. §78j(b),[1] and Rule 10b-5[2] of the Securities and Exchange Commission, and dismissing such action against a corporate defendant, MS&R, Inc. Plaintiff contends that the damages are inadequate and the judgment should also have been entered against the corporate defendant, whereas defendant Rhoades contends that judgment should have been entered in his favor on the liability issue.

The case arises from the sale of 50% of the issued and outstanding stock of MS&R, Inc. by Rochez Bros., Inc. to Charles R. Rhoades on November 13, 1967, in accordance with an agreement of sale dated September 16, 1967, for the price of $650,000. The interest of Rochez Bros. in MS&R began on July 1, 1964, when Rochez Bros. bought 50% of the stock of MS&R for $272,500. At the same time Rhoades, who already owned 33-1/3% of the MS&R stock, brought his stock

[1] "§78j. Manipulative and deceptive devices

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

• • •

"(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

[2] "Rule 10b-5. Employment of Manipulative and Deceptive Devices

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

"(1) to employ any device, scheme, or artifice to defraud,

"(2) to make any untrue statements of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

"(3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."

ownership up to 50%. This evenly divided stock ownership continued until November 13, 1967, when Rhoades bought out Rochez Bros., thus becoming the sole owner of the stock of MS&R. During this time, Rhoades was full-time Chairman of the Board, Chief Executive Officer, and President of MS&R. Joseph Rochez, the President of Rochez Bros., was a part-time Vice President of MS&R and a member of its three-man Board of Directors. Rhoades ran the business activities of MS&R on a day-to-day basis, while Rochez was primarily concerned with general policy matters in relation to finance and growth of the company.

As a result of increasing dissension between the two men, founded both in personality differences and business disagreements, both Rochez and Rhoades were authorized by the Board in the spring of 1967 to contact prospective purchasers of the company, but these efforts produced no results. At this time, they also began discussing a buy-sell agreement whereby one of them would buy out the other's interest. Finally, on September 11, 1967, Rochez Bros. named the price for which it was willing to sell its stock in MS&R to Rhoades, subject to the condition that the sale should be concluded by noon on September 15 and that Rhoades should put $50,000. in escrow, to be forfeited if no closing occurred. On September 16, 1967, an agreement of sale was executed, under which Rhoades bought the stock of Rochez Bros. for $650,000. The closing and delivery of the stock certificates to Rhoades took place on November 13, 1967.

Prior to the September 16 agreement, Rhoades answered a newspaper advertisement placed by one Wingate Royce, of New York City, in January or February of 1967. Royce phoned Rhoades, who told Royce that he was interested in discussing financing for MS&R. Rhoades then sent Royce MS&R financial information and made an

appointment for Royce to come to Pittsburgh on April 21, 1967. Royce did visit the MS&R plant on that date and was introduced by Rhoades to Rochez, who declined to hire him to find a purchaser for MS&R. Rhoades, however, did agree to retain Royce to find leads and make introductions to bring about the sale of MS&R. Rhoades never informed Rochez Bros. of the employment of Royce or of the negotiations for the sale of MS&R that followed.

Thereafter, in May 1967, Royce brought MS&R as a potential acquisition to the attention of J. Walter English, of Simmonds Precision Products Co. In May 1967, English visited MS&R after Royce had informed Rhoades that Simmonds was a potential purchaser. In late August or early September 1967, Rhoades and his production assistant went to Hartford to visit a Simmonds plant. Upon arrival at the Hartford airport, Rhoades telephoned his Pittsburgh attorney's office to learn how the buy-sell negotiations with Rochez Bros. were progressing. They then visited the plant and dined with Simmonds personnel. On the return trip to Pittsburgh, they rode with Geoffrey Simmonds in the latter's company plane, and Simmonds toured the MS&R plant before continuing to a further destination.

Royce also informed Rhoades of the interest of Carus Chemical Company in acquiring MS&R stock. In the latter part of August 1967, the Carus brothers visited the MS&R plant and told Rhoades that Carus would be interested in purchasing MS&R stock.

Upon conclusion of the agreement of September 16, 1967, for the purchase of the Rochez stock, Rhoades increased his efforts to sell MS&R. On September 18, 1967, he telephoned both Simmonds and Carus and began negotiations that led to offers from both. However, the Carus offer was unattractive to Rhoades since it in effect required him, continuing as director, to earn the purchase

price out of future profits of MS&R. The Simmonds offer also fell through, both because Rhoades found it unattractive tax-wise and because Simmonds did not wish to become involved in a possible lawsuit with Rochez Bros. Finally, in April 1968, Rhoades began negotiations with Esterline Corporation, through the initiative of Western Pennsylvania National Bank, which resulted in a formal agreement on July 16, 1968, in which Esterline agreed to pay $4,250,000. in cash and 50,000 shares of Esterline restricted stock for the 100% of MS&R stock then held by Rhoades and two other persons to whom he had sold some shares.

Rochez Bros. brought this action under section 10(b) of the Securities Exchange Act, 15 U.S.C. §78j(b) and Rule 10b-5 of the Securities and Exchange Commission with pendent jurisdiction fraud counts under Pennsylvania law.[3] The case was tried to the court, which entered judgment on January 22, 1973, in favor of Rochez and against Rhoades in the amount of $402,000., with interest from September 16, 1967.[4] The district court on the same day also entered a separate order dismissing the action as to MS&R, the corporate defendant.

I. Liability of Rhoades

Defendant Rhoades contests the district court's decision on the ground that plaintiff failed to demonstrate the following elements necessary to establish liability under

[3] The named defendants were Rhoades and MS&R; two other individual defendants who were officers of MS&R were dismissed during the trial and their dismissal is not involved in this appeal.

[4] The district court held defendant Rhoades liable because of its finding that he failed to disclose material information (with respect to the Simmonds and Carus dealings) before September 16, 1967. It therefore found it unnecessary to decide whether the nondisclosure of material facts between September 16, 1967 (the date of the agreement) and November 13, 1967 (the date of the closing) could give rise to liability.

section 10(b) of the Securities Exchange Act and Rule 10b-5 of the Securities and Exchange Commission.

A. Scienter

The question of whether proof of actual knowledge or willful or reckless disregard of the truth is necessary to establish liability under Rule 10b-5 is an unsettled area of the law. The circuits are divided on this question. Some have adopted a negligence standard. See *City National Bank v. Vanderboom*, 422 F.2d 221, 229-30 (8th Cir.), *cert. denied*, 399 U.S. 905 (1970); *Myzel v. Fields*, 386 F.2d 718, 734-35 (8th Cir. 1967), *cert. denied*, 390 U.S. 951 (1968); *Sevens v. Vowell*, 343 F.2d 374, 379-80 (10th Cir. 1965); *Royal Air Properties, Inc. v. Smith*, 312 F.2d 210, 212 (9th Cir. 1962); *Ellis v. Carter*, 291 F.2d 270, 274 (9th Cir. 1961).[5] However, recently the Second Circuit, sitting en banc, held that scienter was a necessary element in a case involving non-disclosure of material facts. *Lanza v. Drexel & Co.*, CCH Fed. Sec. L. Rep. 93,959 (2d Cir. 1973). This court has never been faced squarely with this issue, and we need not resolve it in this case, since the *Lanza* decision makes clear that to the extent scienter is required, that requirement is satisfied in a non-disclosure case where, as here, the defendant had knowledge of the undisclosed information.[6] See also A. Bromberg, *Securities Law: Fraud*, Vol. 2, ¶ 8.4(521) at p. 204.131, and ¶ 8.4(525) at pp. 204.137-44 (1971). Defendant seems to argue that the scienter test requires further proof that the non-disclosure was willful and not merely negligent, suggesting that in light of the time pressure placed on him to agree to plaintiff's terms, his non-disclosure does not consitute fraud. Defendant does not cite any cases to support this claim,[7] and there is considerable authority against interpreting a scienter requirement as equivalent to a showing of intent to defraud. See A. Bromberg, *supra*, ¶ 8.4(544 at pp. 204.177-81 and cases cited therein. Defendant was under a duty to disclose all material facts to plaintiff, and his failure to do so when he had actual knowledge of those facts satisfies any scienter requirement.[8]

[5] For a thorough analysis and criticism of these cases, see the concurring and dissenting opinion of Adams, J., in *Kohn v. American Metal Climax, Inc.*, 458 F.2d 255, 279-88 (3d Cir. 1972).

[6] The court in *Lanza* stated that "a plaintiff claiming a violation of Rule 10b-5 *who cannot prove that the defendant had actual knowledge of any misrepresentations and omissions* must establish, in order to succeed in his action, that the defendant's failure to discover the misrepresentations and omissions amounted to a willful, deliberate, or reckless disregard for the truth that is the equivalent of knowledge." CCH Fed. Sec. L. Rep. at p. 93,831. (Emphasis added.) The court therefore refused to hold liable a corporation president who had no knowledge of the material facts that other directors had failed to disclose in the course of certain transactions; his mere negligence in not ascertaining those facts was held not to satisfy the scienter requirement.

B. Materiality

The test of the materiality of undisclosed or misrepresented facts is basically an objective one — i.e., whether "a reasonable man would attach importance [to them] in determining his choice of action in the transaction in question." *List v. Fashion Park, Inc.*, 340 F. 2d 457 (2d Cir.), *cert. denied*, 382 U. S. 811 (1965). See also *Myzel v. Fields*, 386 F.2d 718, 734 (8th Cir. 1967), *cert. denied*, 390 U.S. 951 (1968). Under this test there is little doubt that information concerning negotiations by one owner of 50% of the stock of a business with potential purchasers is material, for a reasonable man who owned the other 50% of the stock would surely attach importance to that information in deciding whether to sell out to his co-owner. Defendant's arguments

[7] According to a leading scholar, "no 10b-5 decision squarely requires "'intent to defraud,' or clearly equivalent phrases." A. Bromberg, *supra*, ¶ 8.4 (543) at p. 204.175.

[8] In any case, there appears to be substantial evidence in the record to support an inference that Rhoades' failure to disclose material facts to Rochez was deliberate. See note 9 *infra*.

on this point do not directly dispute this reasoning, but rather contest the district court's finding of those facts held to be material. We must, therefore, review the record to determine if the district court's finding that defendant was engaged in negotiations with Simmonds and Carus for the sale of MS&R, and that these negotiations had reached a stage where their existence and contents were material, is clearly erroneous. See F. R. Civ. P. 52(a).

There is ample evidence that Rhoades hired Royce to find a purchaser of MS&R and that this fact was concealed from Rochez.[9] There was equally adequate proof that Royce helped to arrange the visit for English to MS&R, that

[9] Defendant argues that his hiring of Royce cannot be characterized as a concealment from or a surprise to Rochez since the latter specifically turned down Royce's services after having been introduced to him by Rhoades. This argument overlooks several important facts. Royce testified that "[w]hen he [Rhoades] took me by to meet Rochez, he asked me not to tell them what we were talking about" (N. T. 585). In a memorandum the day before Royce's visit, Rhoades directed that MS&R mail would thenceforth be opened only by MS&R employees and not by Rochez Bros. employees (who shared the same office) (PX-25). Furthermore, Rhoades admitted that he never told anyone from Rochez Bros. about the letter employment agreement with Royce (N. T. 1685). Thus, even if Rochez declined to hire Royce as a finder (as Rhoades testified), it does not relieve Rhoades from the duty of revealing that he had in fact hired Royce in opposition to Rochez's wishes, as found by the district court.

In its January 22, 1973, order dismissing the action as to corporate defendant MS&R, the district court concluded that any wrongdoing of defendant Rhoades was done on his own account as a stockholder and individual and not in the course or scope of his employment by MS&R. This conclusion implies that the district court believed that Royce was not hired by MS&R for corporate purposes, but by Rhoades solely for personal matters. However, the court made no specific findings that Royce was or was not employed by MS&R. See p. 20 *infra*. While this issue is important with respect to the question of the liability of MS&R, it is irrelevant as to Rhoades' liability, since the district court finding of the hiring of Royce is not clearly erroneous, and whether for private or corporate purposes it was a material fact that Rhoades failed to disclose to Rochez.

Simmonds was interested in the prospect of acquiring MS&R and that Rhoades knew it. Defendant contends that his discussions with English concerned only the sale of MS&R products to Simmonds and not acquisition of MS&R by Simmonds. However, there is ample support in English's testimony that acquisition discussions began during that visit.[10] Defendant also contends that his contacts with Simmonds in September 1967 during his trip to its plant near Hartford and the return trip to Pittsburgh had nothing to do with acquisition of MS&R. Again, there is sufficient evidence to support the district court's skepticism toward this contention and its finding that the purpose of the trip was to continue acquisition discussions begun in May.[11] The district court also rejected as improbable the claim by defendant that the visits of the Carus brothers to the MS&R

[10] English testified that on this visit to MS&R, the general nature of his conversation with Rhoades was: "Review of the plant, discussion generally of the business, the business potential, Simmonds, its potential. And general body chemistry, meeting to determine whether Charles Rhoades and Simmonds Precision, represented by myself, could get along (N. T. 1151). English also stated that his next contact with Rhoades in September 1967 was "in furtherance of the negotiations begun in May" (N. T. 1154).

[11] Rhoades argues that the testimony of Hager (N. T. 1342-44), who was the MS&R production vice-president and who accompanied him on this trip, demonstrates that its purpose was to consult with Simmonds on some production problems they were having. However, although Hager testified that he and Rhoades were asked to advise on a production problem, he also stated that he could not say what the purpose of the trip was (N. T. 1308), although he assumed from "the prior month's general activity in our plant, that there possibly could be an acquisition interest from the Simmonds' standpoint." (N. T. 1307). Furthermore, Rhoades' telephone call from the Connecticut airport to his attorney in Pittsburgh to find out if Rochez had finally agreed on a buy-sell arrangement, the presence of Mr. Coombs, a lawyer for Simmonds, at the plant and at the subsequent dinner, and Mr. Geoffrey Simmonds' visit to the MS&R plant after flying back to Pittsburgh in the Simmonds Company plane with Rhoades and Hager, all suggest that the purpose of the visit was to discuss a possible acquisition of MS&R by Simmonds.

plant were merely to look at the computer system employed by MS&R.[12] Defendant argues that even if his version of these visits is not believed, it cannot support the opposite conclusion — that acquisition negotiations with Carus did occur. However, the district court's finding as to these visits does not depend solely upon its disbelief of Rhoades' testimony, but also derives from inferences it could properly make from other evidence in the record.[13] Finally, even if we were to accept defendant's protestations that he rejected all advances made by Simmonds and Carus concerning the purchase of MS&R, it is undisputed that they displayed a strong interest in such an acquisition, and that interest would certainly be a factor affecting the decision of a reasonable man in Rochez's position with respect to the transaction between him and Rhoades. We therefore hold that the district court's findings supporting its conclusion that there were material facts that defendant failed to disclose are not clearly erroneous.

C. Due Care

The cases generally hold that before an insider may claim reliance on a material misrepresentation or non-

[12] The court found that the MS&R plant used a standard IBM computer. The credibility which it chose to give, or not give, to the testimony of Rhoades, and his witness Mr. Monaco, is a matter within the discretion of the district court as trier of fact.

[13] Having found that the purpose of the visit of the Carus brothers was not to look at the MS&R computer, the district court could properly assume that the visit had some purpose and could infer that it was to discuss the acquisition of MS&R by Carus from the following facts. Royce testified that he arranged for the Carus brothers to visit Rhoades and that he later talked to Rhoades and advised him that he would not have to pay Royce a commission if a deal was completed with Carus (N. T. 590-91, 593). Hager testified that he recalled meeting a number of persons or showing a number of persons around the MS&R plant, probably in the second quarter of 1967, who were "connected with an organization that had some interest in acquiring MS&R" and among them were persons from Carus Chemical and Simmonds (N. T. 796).

disclosure, he must fulfill a duty of due care in seeking to ascertain for himself the facts relevant to a transaction. *See, e.g., Financial Industrial Fund, Inc. v. McDonnell Douglas Corp.*, 474 F. 2d 514 (10th Cir. 1973); *Clement A. Evans & Co. v. McAlpine*, 434 F. 2d 100 (5th Cir. 1970), *cert. denied*, 402 U. S. 988 (1971); *City National Bank v. Vanderboom*, 422 F. 2d 221 (8th Cir.), *cert. denied*, 399 U. S. 905 (1970). However, the cases also hold that a plantiff cannot fail in his duty of due care if he lacked any opportunity to detect the fraud. *See, e.g., Johns Hopkins University v. Hutton*, 422 F. 2d 1124 (4th Cir. 1970), *on remand*, 326 F. Supp. 250 (D. Md. 1971); *City National Bank v. Vanderboom, supra; Lehigh Valley Trust Company v. Central National Bank*, 409 F. 2d 989 (5th Cir. 1969). The non-disclosed facts here were in Rhoades' personal knowledge or private files and were not available to Rochez. There is no evidence that any corporate books, records, or minutes available to Rochez contained information with respect to the employment of Royce or the negotiations with Simmonds or Carus. Thus, Rochez's status as an insider, his financial expertise, and his business acumen are all irrelevant, for he had no access to the critical information or any opportunity to discover the non-disclosed facts. We therefore conclude from the record that Rochez adequately fulfilled his duty of due care.

D. Reliance

Recovery under Rule 10b-5 is sometimes said to require a showing that the party seeking damages actually relied on the misrepresentation or omission of material facts. *See, e.g., List v. Fashion Park, Inc., supra* at 462. Thus, while the objective test of materiality (see pp. 8-9, *supra*) provides the basis for the defendant's duty to disclose, the reliance requirement provides the causal link between the non-disclosure and the loss suffered. However, proof of reliance

is not required in all cases under Rule 10b-5. The Supreme Court has recently held:

> "Under the circumstances of this case, involving primarily a failure to disclose, positive proof of reliance is not a prerequisite to recovery. All that is necessary is that the facts withheld be material in the sense that a reasonable investor might have considered them important in the making of his decision. See *Mills v. Electric Auto-Lite Co.*, 396 U. S. 375, 384 (1970); *SEC v. Texas Gulf Sulphur Co.*, 401 F. 2d 833, 849 (2d Cir. 1968), cert denied *sub nom. Coates v. SEC*, 394 U. S. 976 (1969); 6 L. Loss, Securities Regulation 3876-3880 (1966 Supp. to 2d ed. of Vol. 3); A. Bromberg, Securities Law, Fraud — SEC Rule 10b-5, §§2.6 and 8.6 (1967). This obligation to disclose and this withholding of a material fact establish the requisite element of causation in fact. *Chasin v. Smith, Barney & Co.*, 438 F. 2d, at 1172."

Affiliated Ute Citizens v. United States, 406 U. S. 128, 153-54 (1972).[14] We do not read this decision to say that the question of reliance *vel non* may not be considered at all in a non-disclosure case, but only that proof of reliance is not required for recovery. If defendant is able to demonstrate that there was clearly no reliance, that is, that even if the material facts had been disclosed, plaintiff's decision as to the transaction would not have been different from what it was, then the non-disclosure cannot be said to have caused the subsequent loss and under the ordinary principles of the law of fraud, recovery should be denied. See Prosser, *Law of Torts*, §103 (3d ed. 1964). However, in light of the Supreme Court's holding in *Affiliated Ute*, the burden of proof rests

[14] In addition, we have held that in a suit by shareholders suing because of allegedly misleading statements in a proxy report, "to the extent a reliance factor is required, in the present context it is encompassed by the finding that the misrepresentation was material." *Kohn v. American Metal Climax, Inc.*, *supra* at 269.

squarely upon defendant to establish the "non-reliance" of plaintiff.

Defendant stresses a number of facts which he claims show that Rochez would have proceeded to reach the same buy-sell agreement with defendant as he did on September 16, 1967, even if he had known of the negotiations with Simmonds and Carus. First, from earlier negotiations to sell MS&R authorized by the Board of Directors, Rochez knew that Rhoades had valued a 50% interest in MS&R to a possible outside purchaser at $1.75 million, and this was at a time prior to the Babcock & Wilcox contract that proved so lucrative to MS&R. Rochez considered that valuation ludicrously high. Second, Rochez initiated the deal on September 11, 1967, and gave Rhoades only until September 15, 1967, to agree to it and to put up $50,000, which would be forfeited if the closing did not take place. Third, when Rochez set the price at which Rochez Bros. would sell its MS&R stock to Rhoades, he stated that he did not care where Rhoades got the money and that he assumed that Rhoades had outside investors waiting in the wings. These facts demonstrate that Rochez did not share Rhoades' sanguine estimation of the worth of MS&R stock, was most anxious to press forward with the deal, and was unconcerned with the source of the money that was to pay for the shares of MS&R stock held by Rochez Bros. However, they do not compel the conclusion that Rochez would have been indifferent to the amount of money that Simmonds or Carus was willing to pay. Even if it is true, as Rhoades contends, that as of September 16, when the firm commitment was signed, he had not yet received any specific offer from either Simmonds of Carus,[15] the record indicates that negotiations

[15] The September 29, 1967, letter from Geoffrey Simmonds that Rhoades testified contained the first offer of a purchase price begins by stating that it is to confirm the understanding between Simmonds

(continued)

had progressed far enough that an offer of a price by one of the prospective purchasers was to be expected shortly.[16] On the basis of the evidence before it, the district court could properly have concluded that if Rochez had been apprised of the undisclosed facts, he would not have plunged ahead with the buy-sell agreement with Rhoades on the same terms without first finding out how much Simmonds or Carus was prepared to pay, and that these estimates would have influenced his willingness to sell to Rhoades at the price he had originally asked.

E. Conclusion

On the basis of the foregoing analysis, we affirm the decision of the district court as to the liability of defendant Rhoades under Rule 10b-5.

II. The Measure of Damages

In *Affiliated Ute Citizens v. United States, supra,* at 155, the Supreme Court held that the correct measure of damages

---

and Rhoades as to the former's acquisition of MS&R. Rhoades testified on cross-examination that this was a reference to a conversation of the previous day in which Simmonds told Rhoades that he had something of interest that he was putting in the mail. This explanation is dubious since the detailed terms laid out in the letter suggest that there had been prior discussions between Simmonds and Rhoades as to those terms. Furthermore, a letter to Rhoades from Coombs, Simmonds' attorney, dated September 15, enclosed copies of the Simmonds insurance, pension, and disability plans, with a request that Rhoades send to Simmonds corresponding material of MS&R. Such minor details related to integration of two companies are not normally discussed until negotiations have been conducted with respect to the more substantive matters, such as purchase price.

[16] The September 15 letter from Coombs to Rhoades, in particular, indicates that the negotiations had progressed well beyond the point of initial contacts and had reached a rather advanced stage, from which Rochez, had he known of them, might reasonably have concluded that an offer of a purchase price was imminent. This conclusion is supported by the fact that, even according to Rhoades' testimony, the first offer of a purchase price came only 13 days after the signing of the firm commitment on September 16, 1967.

under §28 of the Securities Exchange Act is the difference between the fair value of what the seller received for his stock and what he would have received had there been no fraudulent conduct, "except for the situation where the defendant received more than the seller's actual loss. In the latter case damages are the amount of the defendant's profit." The Court cited as authority for this latter measure of damages the decision in *Janigan v. Taylor,* 344 F. 2d 781, 786 (1st Cir.), *cert. denied,* 382 U. S. 879 (1965), where the First Circuit held:

> "On the other hand, if the property is not bought from, but sold to the fraudulent party, future accretions not foreseeable at the time of the transfer even on the true facts, and hence speculative, are subject to another factor, viz., that they accrued to the fraudulent party. It may, as in the case at bar, be entirely speculative whether, had plaintiffs not sold, the series of fortunate occurrences would have happened in the same way, and to their same profit. However, there can be no speculation but that the defendant actually made the profit and, once it is found that he acquired the property by fraud, that the profit was the proximate consequence of the fraud, whether foreseeable or not. It is more appropriate to give the defrauded party the benefit even of windfalls than to let the fraudulent party keep them."

The court in *Janigan* recognized that there are limits to this principle,[17] but found that those limits were not reached where no extraordinary gains in the company's affairs

---

[17] "If an artist acquired paints by fraud and used them in producing a valuable portrait we would not suggest that the defrauded party would be entitled to the portrait, or to the proceeds of its sale." *Janigan v. Taylor, supra* at 787.

attributable to defendant's own special efforts subsequent to the purchase occurred.[18]

The district court recognized that the measure of damages here is governed by *Janigan* but held that it would be unjust to award Rochez the full value of the amount realized by Rhoades in the sale of MS&R stock to Esterline, since the increase in the value of MS&R was the result partly of Rhoades' aggressive and enterprising management ability and partly of the termination of the divided control. The district court, therefore, used its estimate of the value of the Simmonds offer as the basis to determine plaintiff's damages. The problem with this result is that the facts of this case do not exceed the limits that the First Circuit placed on its damages principle in *Janigan*. Even if Rhoades' aggressive management of MS&R could properly be characterized as constituting a special effort outside the regular duties for which he was paid, there is nothing in the record to indicate any such special efforts took place after the signing of the firm commitment on September 16, 1967.[19] Moreover, the ending of the divided control which the district court stressed as the cause of the increase in the value of MS&R subsequent to September 16 is surely not a valid reason for limiting plaintiff's recovery, since it was by his fraudulent non-disclosure that Rhoades obtained undivided control of MS&R. We do not believe that this is the type of personal effort that the court in *Janigan* intended to except

[18] The court in *Janigan* pointed out that there was no evidence that defendant did anything different or worked any harder following the acquisition than he had before, that the company's improvement was attributable to factors independent of his personal efforts, and that he received a salary for the performance of what were his regular duties. *Janigan v. Taylor, supra* at 787.

[19] Indeed, the only factor alluded to in the district court's opinion affecting the value of MS&R for which Rhoades was responsible was the lucrative Babcock & Wilcox contract which was entered into earlier in 1967.

from its rule of damages. Thus, the district court erred when it refused to compute Rochez's damages on the basis of the value Rhoades received for the MS&R stock from Esterline. The proper measure of damages is the difference between the value of 50% of MS&R stock on the basis of the Esterline purchase price and the amount Rochez received from Rhoades for his share of MS&R.

We can well understand the concern expressed by the dissenting opinion regarding the amount of damages. However, after careful consideration of the language of the Supreme Court in *Ute*, we have concluded that we are bound by the clear rule of damages enunciated in that case. Even assuming that there may be exceptions to the rule of damages set forth in *Ute*, as explicated in *Janigan*, we do not believe that this is a proper case for such an exception.

III. Dismissal as to Corporate Defendant MS&R

The district court entered an order after the trial was completed dismissing the action as to MS&R, which order contained this language:

> ". . . the Court being of the opinion that any wrongdoing of defendant Rhoades was on his own account as a stockholder and individual and not in the course or scope of his employment by the said corporate defendant MS&R Inc., or for the account or benefit of said corporate defendant or attributable in any wise to said corporate defendant, said corporate defendant being instead the passive object of such transfers of its stock as were effected through the activities (wrongful or otherwise) of said defendant Rhoades. . . ."

Plaintiff argues that this order of dismissal was erroneous, since the facts on the record establish liability of MS&R under two theories: first, that there was sufficient "participation" by MS&R to make the corporate defendant an aider,

abettor, or conspirator with Rhoades; second, that MS&R was a controlling person within the meaning of §20(a) of the Securities Exchange Act of 1934, 15 U.S.C. §78t(a), which makes liable a "person" who "controls" one who violates a rule.[20]

It is unnecessary for this court to decide this question at this time, for the district court failed to make findings to support its dismissal as required by Rules 41(b) and 52(a) of the Federal Rules of Civil Procedure. The opinion and judgment against defendant Rhoades, entered the same day as the order dismissing the action against corporate defendant MS&R, does not satisfy the provisions of Rule 52(a), for the findings of fact contained therein do not relate to and cannot support the conclusion stated by the district court in its order of dismissal.

We therefore will vacate the January 22, 1973 order dismissing the action as to MS&R (Document 72, W. D. Pa. Civil No. 68-1048) and remand so that the district court can make the necessary findings of fact. That part of the January 22, 1973, district court judgment (Document 73, W. D. Pa., Civil No. 68-1048) providing for damages of $402,000 will be

---

[20] Section 20(a) of the Act has been applied to Rule 10b-5 violations in *SEC v. First Securities Company of Chicago*, 463 F.2d 981 (4th Cir.), *cert. denied sub nom. McKy v. Hochfelder*, 409 U. S. 880 (1972); and *Myzel v. Fields, supra*. In *First Securities* the court held the company liable for the Rule 10b-5 violation of its president under both theories advanced by plaintiff here. The court held that as an employee, the president is "controlled" by the company within the meaning of §20(a) and that in order for a controlling person to escape liability by showing that it acted in good faith, it must show that some precautionary measures were taken to prevent its employee's violation. The court also reaffirmed its holding in *Buttrey v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 410 F.2d 135, 144 (7th Cir. 1969), that liability predicated on aiding and abetting may be founded on less than actual knowledge and participation in the activity proscribed by section 10 of the Act and Rule 10b-5.

vacated and the case will be remanded to the district court for proceedings not inconsistent with this opinion.

.....

Circuit Judge

RE: *Rochez, Bros., Inc. v. Charles R. Rhoades, and MS&R Inc.*, — Nos. 73-1257 and 72-1258.

HASTIE, *Circuit Judge*, dissenting in part.

I agree that the district court correctly decided the questions of liability. My dissent is limited to the matter of damages. On this issue, all circumstances considered, it seems to me that the district court measured and limited its award of damages in a way that was equitable and proper.

Accordingly, I would affirm judgment in its entirety.

IN THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 73-1257

ROCHEZ, BROS., INC.,
a Pennsylvania Corporation,
Appellant

vs.

CHARLES R. RHOADES,
and MS&R INC., a
Pennsylvania Corporation

(D. C. Civil Action No. 68-1048)

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF PENNSYLVANIA

Present: HASTIE, VAN DUSEN and ADAMS, *Circuit Judges*

JUDGMENT

This cause came on to be heard on the record from the United States District Court for the Western District of Pennsylvania and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this Court that the order of the said District Court, filed January 22, 1973, dismissing the action as to defendant MS&R, INC., be, and the same is hereby vacated, and the cause is remanded for the necessary findings of fact. The order of the said District Court filed January 22, 1973, providing for damages of $402,000., is vacated, and the cause is remanded to the district court for proceedings not inconsistent with this opinion.

Attest:

/s/ THOMAS F. QUINN
Clerk

December 21, 1973

IN THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 73-1258

ROCHEZ, BROS., INC.,
a Pennsylvania Corporation

vs.

CHARLES R. RHOADES
and MS&R INC., a
Pennsylvania Corporation

(D. C. Civil Action No. 68-1048)

CHARLES R. RHOADES, *Appellant*

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF PENNSYLVANIA

Present: HASTIE, VAN DUSEN and ADAMS, *Circuit Judges*

JUDGMENT

This cause came on to be heard on the record from the United States District Court for the Western District of Pennsylvania and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this Court that the order of the said District Court, filed January 22, 1973, be, and the same is hereby affirmed on the issue of liability. Costs taxed against appellant.

Attest:

/s/ THOMAS F. QUINN
Clerk

December 21, 1973

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

Nos. 73-1257 and 73-1258

ROCHEZ, BROS., INC., a Pennsylvania Corporation

v.

CHARLES R. RHOADES, and MS&R INC.,
a Pennsylvania Corporation

ROCHEZ, BROS., INC., a Pennsylvania
Corporation, *Appellant in No. 73-1257*

CHARLES R. RHOADES, *Appellant in No. 73-1258*

(D. C. Civil Action No. 68-1048)

Before HASTIE, VAN DUSEN and ADAMS,
Circuit Judges

OPINION SUR PETITION FOR REHEARING
(Filed January 29, 1974)

VAN DUSEN, *Circuit Judge*.

In his petition for rehearing, defendant Rhoades contends that this court's increase in the amount of damages awarded plaintiff Rochez Bros. by the district court was unwarranted.

First, Rhoades argues that this court misapplied the damage rules of *Affiliated Ute Citizens v. United States*, 406 U.S. 128 (1972), and *Janigan v. Taylor*, 344 F.2d 781 (1st Cir.), *cert. denied*, 382 U.S. 879 (1965), in such a way as

to make the result penal. Rhoades points out that neither *Affiliated Ute* nor *Janigan* considered what effect a plaintiff's knowledge of the non-disclosed facts, subsequent to the transaction out of which the 10b-5 violation arose, would have on the time as of which damages are to be measured. According to the record in this case, in February 1968 Rochez received a telephone call from Royce, who informed him that negotiations had been going on with Simmonds, that an offer had been received from Simmonds in the form of stock, and that in Royce's view, the offer was in excess of $2 million, although the exact amount was not disclosed (N.T. 600-01). Rhoades maintains that while the receipt of such information did not impose any duty on plaintiff to institute suit against him, the "high water mark" of plaintiff's damages should be fixed at the date he received this information, i.e., February 1968. The consequence of this limitation would be to establish the Simmonds offer as the measure for plaintiff's damages, since negotiations for the sale of MS&R to Esterline (the eventual purchaser) did not begin until mid-April 1968.

In support of this limitation on the *Janigan* "benefit of the bargain" rule of damages, Rhoades relies on the decision in *Baumel v. Rosen*, 412 F.2d 571 (4th Cir. 1969), *cert. denied*, 396 U.S. 1037 (1970). In that case, defendants' purchases of stock from plaintiffs in August 1959 were found to have been procured through affirmative misrepresentations of the financial condition of the company and under non-disclosure of material incidents in the corporate operations. Plaintiffs first received information indicating that they might have been defrauded sometime in the fall of 1959,[1] but did not renounce their sales to defendants by filing

[1] One of the plaintiffs admitted that shortly after the sale he believed "he had been taken," while the other plaintiff testified that at Thanksgiving or Christmas of 1959 he had been told that the company "had plans to go public and that the stock was worth a lot of money more than I had received for it." 412 F.2d at 574.

their suits until August 16, 1962. Because this delay of three years was found to be unreasonable and because of the fluctuating character and value of the stocks in question, the Fourth Circuit reversed the trial court and held that plaintiffs were not entitled to the equitable remedy of rescission. Turning to the question of damages, the court applied the *Janigan* rule, but limited its computation of damages to a period which ended with the first stock split and public offering of March 8, 1961, at which time the trial court found plaintiffs knew, or should have known, of the fraud. To allow damages to be calculated on the basis of the value of plaintiffs' prior interest at the time of the second stock split, in March 19, 1962, as plaintiffs contended, would permit, according to the court, a recovery grossly disproportionate to the harm done and hence constitute a penalty not intended by the Securities Act.

In evaluating the relevance of the *Baumel* decision to the instant case, it is important to bear in mind that the limitation on the measure of damages there, was, in the words of the *Baumel* opinion, "[b]ecause of the volatile nature of first-offering stock prices, and in the circumstances of this case . . . . 412 F.2d at 576. It is clear from the opinion that the circumstance of overwhelming importance in that case was the unreasonably long delay of plaintiffs in initiating their 10b-5 actions — three years from the time they first had reason to suspect fraud and 18 months from the time they had reason to know for sure that they had in fact been duped — during which the value of their prior interest increased dramatically. Thus, the purpose of the limitation was to prevent a defrauded party from delaying unreasonably the commencement of his suit in order to reap an excessive recovery because of the increased value of speculative property that he had fraudulently been induced to sell. Such a limitation is consistent with the reasoning of the First Circuit in *Janigan* that "[i]t is more appropriate to

give the defrauded party the benefit even of windfalls than to let the fraudulent party keep them," 344 F.2d at 786, since in a case like *Baumel* the defrauded party is no longer himself completely free of wrongdoing and is thus not entitled to windfalls subsequent to his learning of the fraud.[2]

However, we must note that subsequent to *Baumel* the Supreme Court in *Ute* approved of the *Janigan* rule of damages in terms that are unequivocal and unqualified. 406 U.S. at 155, quoted at p. 13 of the December 21, 1973, opinion of the court, *supra*. Nothing in that language suggests the sort of limitation applied by the Fourth Circuit in *Baumel*.

Furthermore, on its facts, the instant case is clearly distinguishable from *Baumel*. Although Rhoades was able to bargain the price of MS&R up considerably from February 1968 (when Rhoades first learned of the Simmonds offer) to July 16, 1968 (when the agreement to sell to Esterline was signed), the MS&R stock was not of the same highly volatile nature as was the stock in *Baumel*. More importantly, unlike the plaintiffs in *Baumel* who waited for three years, Rochez brought this action (on September 11, 1968) within a reasonable time (approximately six months) after first learning that he might have been defrauded. There is no

---

[2] This interpretation of the purpose of the limitation of damages in *Baumel* does not conflict with the court's fixing, as the cut-off point for evaluating plaintiffs' prior interest, the time they learned or should have learned of the fraud. It might be argued that it would be more consistent with the goal of discouraging unreasonable delays in commencing suits to set as the time limit the point at which the delay became unreasonable. However, such a rule would burden the courts with the necessity of determining when that point occurred, and such determination would tend to be somewhat arbitrary. Moreover, even if the courts were to establish a definite length of time as a standard for deciding this unreasonable delay issue, such a rule would encourage delays within the time span determined to be reasonable.

evidence of any intent on the part of Rochez to delay commencing this suit in order to gain windfall profits from the sale of MS&R. On the contrary, Rochez told Royce at the time of their conversation "that he would be perfectly delighted to get together with Mr. Rhoades and me [Royce] and discuss an adjustment and a compromise of the respective interests, and this would leave it up to Mr. Rhoades to make an adjustment and compromise whether he wanted to go through with the [Simmonds] deal or not. If he wanted to go through with the deal, fine. If he didn't that was fine, too." (N.T. 601).[3] In the absence of an unreasonable delay, there is no basis, in the *Baumel* decision, to limit the award of damages by the value of the Simmonds offer in February 1968; to do so might enable a fraudulent seller who anticipated being sued to limit his potential liability merely by informing or having someone else inform the defrauded party of facts suggesting that he was defrauded.

Finally, even if we were to apply *Baumel's* limitation on the *Janigan* rule to this case, the measure of damages would remain just as we held it to be in the December 21, 1973, opinion of the court, *supra*. The information which Rochez received from Royce in February 1968 was uncertain and incomplete. Rochez could not be sure that Royce was telling the truth about the Simmonds offer or that he was even working for Rhoades. The exact amount of the Simmonds offer was not revealed, and in any case that offer was made in the course of continuing negotiations which had not yet been and never were successfully completed. Also, no mention was made of the negotiations with Carus. Thus, at

[3] It is irrelevant that in January 1968, Rochez received an offer from Rhoades through an intermediary to resell all of the stock of MS&R back to him at the same price which Rhoades had paid and that this offer was rejected. Nothing in the record indicates that as of January 1968 Rochez was aware of the negotiations between Rhoades and Simmonds and Rhoades and Carus.

that time Rochez's position was analogous to that of the plaintiffs in *Baumel* when they first learned that they might have been defrauded. However, the court in *Baumel* set as the time limit for assessing the value of plaintiffs' prior interest *not* the point at which they first realized that they might have been defrauded (fall of 1959), but the date of the public offering of the company's stock (March 1961), when they learned or should have learned *for certain* that their sale of stock had been fraudulently induced. In this case, Rochez could not be certain that he had been defrauded until he met with Royce in August 1968, which was after the sale of MS&R to Esterline. During that meeting, Rochez saw for the first time the agreement whereby Rhoades employed Royce to aid him in finding a buyer for MS&R and Royce's daily diary containing a number of entries relating to telephone conversations that he had with Rhoades concerning the negotiations with Simmonds and/or Carus. (N.T. 101-102). Furthermore, there is no evidence in the record to suggest that constructive knowledge could be imputed to Rochez of these matters, and the district court made no such finding here. Thus, if any time limitation should be imposed in assessing damages in this case, it would be August 1968. Such a "limitation" would mean that Rochez could recover no more than the difference between the price at which he sold his share of MS&R to Rhoades and the value of a 50% share in MS&R at the price at which Rhoades sold to Esterline in July 1968. That, of course, is precisely the measure of damages that this court has ruled to be appropriate in this case.

Second, Rhoades also argues that there can be no recovery under Section 10(b) of the Act in this case since the trial court found that at the time of the transaction Rochez Bros. received the fair market value for the MS&R stock it sold to Rhoades, and hence plaintiff suffered no economic harm. Assuming, without deciding, that the district court's

finding on this point is not clearly erroneous,[4] we nevertheless hold that Rhoades' fraudulent conduct did cause Rochez financial injury. The district court found, and this court has affirmed, that if Rochez Bros. had known of the facts which Rhoades failed to disclose to it, it would not have sold its stock in MS&R for $598,000. in November 1967, since it would have had reason to believe, as subsequent events confirmed, that a greater gain would have been realized by retention of the stock. See *Baumel v. Rosen*, 412 F.2d at 573.[5] Rhoades cites no cases holding that a defrauded seller may not recover unless he received for his stock a price that was less than its market value at the time that such seller sold it, and neither *Janigan* nor *Ute* was predicated upon that circumstance. The reasoning of the First Circuit in *Janigan* that "it is simple equity that a wrongdoer should disgorge his fraudulent enrichment," 344 F.2d at 786, would apply with equal force whether or not the defrauded seller received less than market value for his stock. It is true that in *Ute* the Supreme Court held that a defrauded seller's damages are

---

[4] The district court's finding that the $598,000. that Rochez received for his 50% share in MS&R was the fair market value seems inconsistent with the fact that at the time the agreement of sale was signed on September 16, 1967, Rhoades was already engaged in negotiations with Simmonds that resulted in an offer on September 29, 1967, to buy MS&R for roughly $2 million. As one leading scholar has noted:

> "There are, of course, difficulties in determining value of securities sold upon material misrepresentation or omission. They are greatest for closely held securities. If there is prompt resale, it provides obvious evidence of 'true' value." A. Bromberg, *Securities Law: Fraud*, Vol 3, 9.1 at p. 228 (1973).

[5] In *Baumel* the Fourth Circuit affirmed a finding of the district court that plaintiffs had suffered sufficient economic loss to recover, despite the fact that they sold their stock at a price returning them a profit of 900%. The court's reasoning was the same as ours here, since, but for the fraudulent misrepresentation and non-disclosure, plaintiffs would have retained their stock and ultimately would have realized an even greater gain.

the amount of defendant's profits in those cases where the defendant received more than the seller's "actual loss." 406 U.S. at 155. However, the clear intent of the *Ute* rule of damages, read in its entirety and in light of *Janigan*, is to give a defrauded seller the benefit of whichever measure of damages provides the greater recovery: either the difference between the sale price of the stock in the fraudulent transaction and its fair market value at that time or the amount of the fraudulent buyer's profit on resale. In light of the Supreme Court's adoption of this liberal approach to damages, the words "actual loss" should not be read to create a requirement that the defrauded seller should sell his stock for less than its fair market value at the time of the fraudulent transaction. Indeed, to do so would create the anomalous result that a defrauded seller in the above circumstance would receive *no* recovery, while one who had received even a small amount less than the market value for his stock would recover not the difference between what he received and the fair market value but the full amount of defendant's profit on resale.

Rhoades' reliance on the conclusion of the district court that the increased value of MS&R was attributable to his own special efforts and that, therefore, Rochez was not entitled to recover the amount of Rhoades' profits has been considered and rejected in the December 21, 1973, opinion, *supra* at pp. 14-15.

A majority of the above panel votes to deny the petition for rehearing and joins in this opinion. Judge Hastie has no objection to this opinion, but adheres to the views expressed in his December 21, 1973, opinion dissenting in part.

.....

Circuit Judge

IN THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF PENNSYLVANIA

ROCHEZ BROS. INC.,
a Pennsylvania Corporation,
Plaintiff,

v.

CHARLES R. RHOADES, *et al.*
Defendants.

Civil Action No. 68-1048

OPINION

(Filed September 26, 1974.)

DUMBAULD, *J*.

The facts in this case are fully set forth in our former opinion, *Rochez Bros. Inc. v. Rhoades*, 353 F. Supp. 795 (W.D. Pa. 1973). It is sufficient here to say that we held that a violation of Rule 10b-5 of the Securities and Exchange Commission by defendant occurred by reason of his failure to disclose to plaintiff information reasonably affecting the value of the stock purchased by defendant from plaintiff. (*Ibid.*, at 803). This ruling was affirmed in *Rochez Bros. Inc. v. Rhoades*, 491 F.2d 402, 411. (C.A. 3, 1974).

With respect to the measure of damages, however, the majority of the panel (Judges Van Dusen and Adams; Judge Hastie dissenting) held that "the district court erred when it refused to compute Rochez's damages on the basis of the value Rhoades received for the MS&R stock from Esterline. The proper measure of damages is the difference between the value of 50% of MS&R stock on the basis of the Esterline purchase price and the amount Rochez received from Rhoades for his share of MS&R." (*Ibid.*, at 412)[1] At the same

[1] This measure of damages was thought to be required by *Affiliated Ute Citizens v. U.S.*, 406 U.S. 128, 155 (1972), a case arising out of distribution of tribal property of the nation's Indian wards.

time the majority of the panel remanded for findings of fact in accordance with Rules 41(b) and 52(a) to support the dismissal of the corporate defendant MS&R (*Ibid.*, at 413).

Actually, this Court's order of dismissal with respect to MS&R was not conceived as an exercise of the function "as trier of the facts" to "determine them", as contemplated in Rule 41(b), but simply as the equivalent of a ruling in a jury case as a matter of law that there was insufficient evidence to go to the jury with respect to that defendant. See Tr. 1372-75, 1383-91, 1982-89.

Pursuant to remand, after the pleasure of further hearing the able counsel involved in the case, we proceed to consideration of the points now presented, including plaintiff's new argument under §20(a) of the Securities Exchange Act of 1934, 15 U.S.C. 78 t(a), which was first presented to the Court of Appeals and is outlined in the majority opinion (491 F.2d at 413, and note 20). It was fully briefed and argued at the hearing upon remand.

The first matter for disposition is the amount of damages. Plaintiff wishes to reopen the testimony for the purpose of offering the views of an expert witness as to the proper discount factor to take account of the restrictions on marketability to which the Esterline stock received by defendant was subject. Defendant opposes reopening the record, and also stoutly reiterates that the present record contains no adequate proof permitting computation of this item of damages. Hence defendant concludes that plaintiff, having made its bed, must lie in it.

We agree that ordinarily when testimony is completed, the case must be disposed of upon the record as made, not upon a better record which might have been made.

Crowded calendars make it unwise judicial economy to luxuriate in further hearings which might permit more precise and accurate determination of damages.

Defendant rightly points out that the appellate court's mode of measuring damages did not come as a surprise to plaintiff. In fact all through the trial plaintiff urged that the Esterline offer, rather than the Simmonds offer, should be taken as the yardstick for measuring the damages. Hence we must assume that in the record as already made plaintiff's counsel has presented data which in his professional judgment are adequate for determination of the damages sustained.

Under these circumstances we examine the opinion of the appellate court for guidance. We find therein no direction that additional evidence be taken. We find no criticism in that opinion of the mode of calculation (by a statistically arbitrary figure, such as the "standard deduction" in income tax practice, designed to ascertain the approximate quantification of an admittedly existing but not precisely measurable item) used by the District Court.[2] The defect in the District Court's determination was not in the method used, or the inadequacy of the evidence to support it, but simply that Simmonds stock instead of Esterline stock was thus evaluated.

We therefore deny plaintiff's request to reopen, and proceed to determine the amount of damages in the light of the present record.

As stated in Plaintiff's Brief (ordered to be filed of record) "the judgment against Rhoades should be in the amount of $2,125,000.00 (one-half of the $4,250,000.00 [cash

[2] See 353 F. Supp. at 806.

paid by Esterline]), less $598,000.00 (the sale price from Rochez to Rhoades), or $1,527,000.00 plus the value of 25,000 shares of Esterline restricted stock plus interest from July 23, 1968, the date of closing. . .PX 36 shows the market value of Esterline. . .as $53-1/2 bid and $54-1/2 asked. . . .PX 22 sets forth the restrictions" affecting the 50,000 shares received by Rhoades. (Pages 2-4 of Brief). The restrictions prohibit sale for one year (and thereafter unless Esterline registers the stock or its counsel holds that registration is not required by law). After three years Rhoades could request Esterline to make efforts to effect registration, but only once and then at a time when Esterline would not have to prepare additional financial statements for that purpose. Taking the mean market value at $54 per share, and allowing an arbitrary factor for lack of ready marketability, we find that $1,000,000.00 is a proper value for the Esterline stock. Total damages are therefore $3,125,000.00 with interest at 6 per cent from July 23, 1968, and judgment is entered in that amount against defendant.

Turning to the liability *vel non* of MS&R, the Court remains of the view that no sufficient evidence appears in the record to establish liability of this corporate defendant. At the time of the original ruling, the only activity where corporate facilities or employees were used by Rhoades in the scope of their duties was when the computer operator or other clerical people prepared forecasts embodying various assumptions furnished by Rhoades. As counsel have pointed out, however, these forecasts were not relied upon by plaintiff in the course of business nor by the Court in determining defendant's violation of Rule 10b-5 (See 353 F. Supp. at 802). Conceding that under Nuremburg Trials principles, the orders of superior officers are not necessarily an excuse for unlawful acts, nevertheless it seems to us that the employees who performed these mechanical and

ministerial functions under the instructions of Rhoades had no reason to know that they were doing anything unusual or unlawful or fraudulent.[3] Since they were guilty of no wrong in exercising their normal corporate functions, no wrong is attributable to MS&R under the doctrine of *respondeat superior*.

Considering now *de novo* the plaintiff's new theory of liability under Section 20(a) [15 USC 78 t(a)], we find no liability on the part of MS&R under that theory.

This provision of the statute provides:

> Every person who, directly or indirectly, controls any person liable under any provision of this chapter or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.

There is no proof in the record of the case at bar which would tend to show lack of good faith on the part of MS&R as a corporate entity distinct from Rhoades, nor is there any proof that MS&R as such a corporate entity "induced" Rhoades to commit "the act or acts constituting the violation" of Rule 10b-5.

The purpose of this provision obviously is to prevent the true owner of a business from escaping liability by insulating the parent company from the questionable activities by use of subsidiary corporations, or other amenable agents or

---

[3] Knowledge of a wrong, and substantial assistance in effecting it, are prerequisites for establishing liability on the "aiding and abetting" theory. *Landy v. F.D.I.C.*, 486 F.2d 139, 162-63 (C.A. 3, 1973). See also *Sennott v. Rodman & Renshaw*, 474 F.2d 32, 39 (C.A. 7, 1973).

straw parties. The provision is similar to those of the Interstate Commerce Act regarding "control" of carriers [49 U.S.C. 5(2)], or those of the Public Utility Holding Company Act [15 U.S.C. 79b(a)(7)(B)] in the utilities field. It contemplates "penetrating the corporate veil" in appropriate cases, when demanded by the public interest.

The cases relied upon by plaintiff will be found to involve situations where the defrauded or complaining party has had dealings with the corporation, in the ordinary course of its business, and employees of the corporation have taken advantage of the relationship for their own private gain. In the *Ute* case, for example, which plaintiff cites as an authority under Section 20, though the Supreme Court does not cite that section (see 406 U.S. at 152-54), the bank was a recognized agency playing a part in the statutory scheme for distributing tribal Indian property, and held all the stock certificates and defendants were under a fiduciary duty towards the Indians; in spite of which they undertook to make a market for and encourage sales of stock, rather than discouraging it and calling attention to the mandatory legend on the certificates warning the beneficiaries that the value of the stock was uncertain and that it was of a distinctive character and not ordinary stock in a business corporation (406 U.S. at 138). It seems quite proper that the Court should conclude, under the circumstances of the *Ute* case, that "The liability of the bank, of course, is coextensive with that of Gale and Haslem." (406 U.S. at 154). The acts violative of 10b-5 were "acts performed when they were obligated to act on behalf of the mixed-blood sellers" (406 U.S. at 154).

In the case at bar, however, MS&R as a corporate entity entered into no relationship with plaintiff. The stock transaction in connection with which a violation of 10b-5 occurred was *res inter alios acta* insofar as MS&R was

concerned. It did not own or sell its own stock. It did not issue any shares of its own stock as in a "take-over" of another corporation.[4] The deal was purely one between plaintiff and defendant as individual stockholders.

Likewise, in cases involving relationships between investors and stockbrokers or investment counsel, it seems clear that "control" in the Section 20 sense is appropriately found to exist there. *SEC v. First Securities Co.*, 463 F.2d 981, 987 (C.A. 7, 1972). But again, the dealings between the investor and the firm involve a relationship which did not exist in the case at bar. Plaintiff, himself a shrewd and successful businessman, did not seek any investment advice from the corporation in which he owned a 50 percent interest.

Plaintiff seeks to make much of the fact that Rhoades required MS&R mail to be opened by MS&R employees, and not by plaintiff's employees. This seems to be a normal consequence of the separation of the affairs of the two companies which took place in 1967 (See 353 F. Supp. at 799). In *SEC v. First Securities Co.*, 463 F.2d 981, 985 (C.A. 7, 1972), the fraudulent president of the company had forbidden anyone else "to open mail addressed to him, even if it was addressed to First Securities for his attention." In that case, there was a specific duty of supervision of the firm's officers and employees imposed by Rule 27 of the N.A.S.D. which was violated by the mail secrecy. (*ibid.*, at 988). No such rule exists which plaintiff may invoke in the case at bar.

---

[4] Cf. the issuance of debentures in *Escott v. Bar Chris Corp.*, 283 F. Supp. 643, 654 (S.D.N.Y. 1968), where the corporation, however, was not a defendant; and the exchange of shares in *Lanza v. Drexel & Co.*, 479 F.2d 1277, 1286 (S.D.N.Y. 1973), involving an acquisition by the same corporation. See also Judge Judd's comments in *Moerman v. Zipco., Inc.*, 302 F. Supp. 439, 447-48 (E.D.N.Y. 1969), aff'd 422 F.2d 871 (C.A. 2, 1970).

Accordingly, after consideration of plaintiff's new theories of liability, we conclude that no case has been proved establishing liability on the part of MS&R.

This opinion shall be deemed to constitute the Court's findings of fact and conclusions of law. In addition we have made such acceptable findings as counsel for MS&R have submitted as desirable and constituting in their opinion an adequate basis (under the Court of Appeals opinion) for supporting this Court's conclusion with respect to MS&R.

JUDGMENT

AND NOW, this 25th day of September, 1974, for the reasons set forth in the foregoing opinion,

IT IS ORDERED, ADJUDGED, DECREED, AND FINALLY DETERMINED, that judgment be and it hereby is entered in favor of plaintiff Rochez Bros. Inc., and against defendant Charles R. Rhoades, in the amount of $3,125,000.00 with interest from July 23, 1968;

AND IT IS FURTHER ORDERED, that the above-styled action be and it hereby is dismissed as against the corporate defendant MS&R.

/s/ EDWARD DUMBAULD
United States District Judge

Copies to:

RALPH GERMAN, Esquire
1330 Oliver Bldg.
Pittsburgh, Pa. 15222

GREGORY KERR, Esquire
10th Floor, Porter Building
Pittsburgh, Pa. 15219

EDMUND S. RUFFIN, Esquire
2900 Grant Building
Pittsburgh, Pa. 15219

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA

ROCHEZ BROS. INC.,
a Pennsylvania Corporation,
Plaintiff,
v.
CHARLES R. RHOADES, *et al.*
Defendants.

Civil Action No. 68-1048

ORDER

(Filed October 8, 1974.)

AND NOW, this 8th day of October, 1974, upon consideration of this Court's judgment of September 25, 1974, and it appearing that by inadvertent miscalculation the amount of said judgment is incorrect and inconsistent with the Court's opinion.

IT IS ORDERED, that said judgment be and it hereby is vacated, and that

IT IS ORDERED, ADJUDGED, DECREED, AND FINALLY DETERMINED that judgment be and it hereby is entered in favor of plaintiff Rochez Bros. Inc., and against defendant Charles R. Rhoades, in the amount of $2,527,000.00 with interest from July 23, 1968;

AND IT IS FURTHER ORDERED that the above-styled action be and it hereby is dismissed as against the corporate defendant MS&R,

AND IT IS FURTHER ORDERED, that the effective date of this judgment and the lien thereof shall be computed and continue from and after the entry of the said judgment entered on September 25, 1974, which this judgment amends and supersedes.

/s/ DUMBAULD
United States District Judge

Copies to:
RALPH GERMAN, Esquire
1330 Oliver Building
Pittsburgh, Pa. 15222
GREGORY KERR, Esquire
10th Floor, Porter Building
Pittsburgh, Pa. 15219
EDMUND S. RUFFIN, Esquire
2900 Grant Building
Pittsburgh, Pa. 15219

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 74-2209

ROCHEZ BROTHERS, INC.
a Pennsylvania corporation,

v.

CHARLES R. RHOADES,
Appellant

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA

Argued May 16, 1975
Before STALEY, ROSENN and HUNTER, *Circuit Judges*

OPINION OF THE COURT

(Filed November 20, 1975)

By STALEY, *Circuit Judge*.

For the third time, we are presented with an appeal arising from litigation spawned by a fraudulent stock transaction involving Charles Rhoades and Rochez Brothers, Inc. *Rochez I*[1] dealt with the liability of Rhoades for violating Rule 10b-5 of the Securities and Exchange Commission and also with the proper measure of damages; *Rochez II*[2] concerned the secondary liability of MS&R, Inc.,

[1] *Rochez Bros., Inc. v. Rhoades*, 491 F.2d 402 (3d Cir. 1974)

[2] *Rochez Bros., Inc. v. Rhoades*, — F.2d — (No. 74-2208, 3d Cir., September 29, 1975)

the employer of Rhoades. *Rochez III*, the present appeal, asks this court to consider, *inter alia*, whether the stock that is part of the damage award has been properly valued.

The facts of this case have been exhaustively set forth in prior opinions by this court and by the district court. *Rochez I* and *II*, *supra* notes 1 and 2. It is sufficient, therefore, to summarize the events and procedural poise of this case.

Charles Rhoades was found guilty of violating Rule 10b-5. In determining damages, the district court first established that it would be unjust to award Rochez the full value of what Rhoades received from his sale of MS&R stock. The court reasoned that the increase in value of that stock was due to Rhoades' management abilities. *Rochez v. Rhoades*, 353 F.Supp. 795, 803-04 (W.D.Pa. 1973). The district court held that the measure of damages should be to place Rochez in the same position it would have been in, had Rhoades disclosed the Simmonds offer.[3] That court then determined Rochez's damages and based its estimate of value on the Simmonds offer. This court in *Rochez I* affirmed Rhoades' liability but vacated and remanded to the district court so that damages could be correctly determined. In his analysis of the measure of damages, Judge Van Dusen applied the "Janigan Rule"[4], finding that the personal effort as determined by the district court was not what Janigan had intended as an exception to its rule of damages. *Rochez I*, *supra* at 412. Judge Van Dusen then held that the district court "erred when it refused to compute Rochez's damages on the basis of the value Rhoades received for the MS&R stock from Esterline." *Rochez I*, *supra* at 412. The court

[3] The Simmonds offer was an earlier transaction by Simmonds, Inc. to purchase MS&R, Inc. See the district court's opinion at 353 F. Supp. 795, 804.

[4] *Janigan v. Taylor*, 344 F.2d 781, 786 (1st Cir. 1965) *cert. denied*, 382 U.S. 879 (1965).

concluded that the "proper measure of damages is the difference between the value of fifty percent of MS&R stock on the basis of the Esterline purchase price and the amount Rochez received from Rhoades for his share of MS&R." *Rochez I, supra* at 412. On remand, the district court mechanically applied this formula, and it is from this determination that Rhoades appeals.

Appellant has presented several issues for review by this court.

He first contends that Rochez cannot use the rescissional or restitutional rule of damages of *Janigan* and *Affiliated Ute*.[5] Appellant reasons this is so because Rochez delayed seven months in filing his complaint after having received notice of the fraud. This issue has previously been resolved in *Rochez I*. Judge Van Dusen found that there was no unreasonable delay in filing the complaint, and the rules of damages announced in *Affiliated Ute* and *Janigan* were properly applied. *Rochez I, supra* at 415-16. We accordingly will not consider this issue.

Appellant next argues that Rochez is limited to recovering tort damages for fraud and deceit. This question has also been decided by this court in *Rochez I*, and we need not review it again. See *Rochez I, supra* at 411-12.

The third argument of appellant is that if the rescissional rule applies, the restricted Esterline stock should have been awarded in kind. We believe the Restatement of Restitution, Sections 151 and 202, compels us to reject this argument. A plain reading of these sections and the accompanying comments evinces that Rhoades is not the party having a right to elect whether Rochez is to receive the value of the Esterline stock or the actual shares of Esterline stock. That election is a privilege held by the injured party, Rochez.

---

[5] *Affiliated Ute Citizens v. U.S.*, 406 U.S. 128, 155 (1972)

Appellant finally contends that the district court erroneously valued the restricted Esterline stock that is part of the damage amount. As we mentioned earlier, Judge Van Dusen remanded the damage issue because the district court improperly determined damages. On remand, the district court applied the damage formula as outlined in *Rochez I* and, as instructed, evaluated the Esterline stock. Damages were then determined to be $2,125,000 (one-half of the $4,250,000 cash paid by Esterline, less the $598,000 sale price Rhoades got from Rochez, plus the value of 25,000 shares of Esterline restricted stock). The Esterline stock was valued at $1,000,000,000. This figure was based on the market value of Esterline shares at $53⅛ bid, $54⅛ asked, less a discount factor between twenty-five and twenty-six percent because of the restrictions on the stock.

Judge Van Dusen's opinion did not specifically instruct the district court to take further evidence regarding the value of the Esterline stock. This would indicate that the question of opening the record to take more evidence was left to the sound discretion of the district court.

Plaintiff, Rochez, filed a motion to open the record and take new testimony.[6] Briefs were submitted and arguments were heard regarding whether further evidence should be taken. Rochez specifically asked that testimony be taken on what proper discount factor should be applied to determine the value of the restricted Esterline stock. Arguing in

---

[6] Generally, whether a trial court will reopen a case to take more testimony is discretionary with that court. In deciding whether to reopen a case, the district court should be concerned with several factors: What burden, if any, will be placed on the parties and their witnesses; what undue prejudice may result by not taking new testimony; and what consideration should be given to judicial economy. See 5A C.J.S. Appeal & Error §1606 (1958). See also *United Mine Workers v. Gibbs*, 383 U.S. 715, 724-25 (1966).

opposition to Rochez's motion to reopen, Rhoades contended that plaintiff failed to carry his burden of proof as to what value should be placed on the Esterline restricted stock. The district court denied plaintiff's motion. The court held that since Rochez had urged all through trial that the Esterline stock should be the measure of damages, it must be assumed that the record would contain all facts relevant to the value of Esterline. The court further held that "judicial economy" requires that it not conduct hearings to allow plaintiff to offer more precise evidence for determining the value of the Esterline stock. The district court then examined the opinion in *Rochez I* and concluded that the only error in its determination of damages was that the Simmonds stock, instead of Esterline stock, was evaluated. The court thereupon determined the market value of Esterline stock and applied a discount factor because of the restrictions. Appellant, Rhoades, now argues that this determination was erroneous because there was no evidence in the record that could establish the value of the Esterline restricted stock.

Our examination of the record fails to disclose sufficient evidence for determining the value of the Esterline stock. No testimony was ever introduced regarding discount factors for the restrictions on the stock. The only facts before the district court were the actual restrictions on the stock and the over-the-counter bid and asked prices of unrestricted Esterline stock.

The plaintiff has the burden of proving every element of his case, including damages that flowed from the alleged injury. The record shows that plaintiff Rochez was permitted, over strenuous objection, to introduce evidence on the value of unrestricted Esterline stock. There is, however, no evidence pertaining to a discount factor applicable to the lettered Esterline stock. It appears that Rochez failed to place into evidence all the necessary elements for an accurate determination of damages. Failure

to put into evidence all the proof necessary for sustaining a judgment is generally fatal. *Youngstown Sheet & Tube Co. v. Lucey*, 403 F.2d 135, 139 (5th Cir. 1968). Further, on review, a case is ordinarily not remanded to give a party the opportunity to supply the missing evidence. *Moses Lake Homes, Inc. v. Grant County*, 276 F.2d 836, 853 (9th Cir. 1960). There are, however, certain instances in the interest of justice that call for judicial tolerance and a remand may be possible. An appellate court may remand to permit more evidence to be introduced when the deficiency of proof results from a misunderstanding among the parties and the trial court. *Moses, supra;* the ambiguity of the rules of practice and procedure, *Youngstown, supra* at 140. We can find no facts in the present case to which the above circumstances would apply. However, a remand is sometimes necessary where it would insure substantial justice. *Hormel v. Helvering*, 312 U.S. 552, 556. Here, injury has plainly been shown and liability has been conclusively established. Damages have substantially been determined with the exception of the Esterline stock. Although the law does not command mathematical preciseness from the evidence in finding damages, sufficient facts must be introduced so that a court can arrive at an intelligent estimate without speculation or conjecture.

From the state of the present record, we know damages are to be based on the restricted Esterline stock. What is not shown by the record is evidence pertaining to the restrictions on the stock and how the value is affected because of those restrictions. The trial court did an admirable job in arriving at a value even though the calculations were based on the wrong stock.[7] As the district court said, there is little

[7] Rochez I, 491 F.2d 402, determined that the Esterline stock, rather than the Simmonds stock, should be valued. The court did not question whether the district court properly valued the Simmonds stock.

guidance for the courts in this area of lettered stock. It seems to us that it is better that a court weigh evidence on this matter as presented to it by experts rather than speculate as to what factors are, or can be considered.

Accordingly, we remand this case to the district court with instructions to take further testimony only regarding the correct discount factor that would apply to the Esterline restricted stock.

For the foregoing reasons, the case will be remanded to the district court for proceedings consistent with this opinion.

/s/ AUSTIN L. STALEY
Circuit Judge

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 74-2209

ROCHEZ BROTHERS, INC., a Pennsylvania corporation

vs.

CHARLES R. RHOADES, WENDELL E. HAGER, JR., ROY E. JOHNSON, MS&R INC., a Pennsylvania corporation, and BABCOCK ELECTRONICS CORPORATION

CHARLES R. RHOADES, *Appellant*

(D.C. Civil Action No. 68-1048)

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA

Present: STALEY, ROSENN and HUNTER, *Circuit Judges*

JUDGMENT

This cause came on to be heard on the record from the United States District Court for the Western District of Pennsylvania and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court, entered September 25, 1974, be, and the same is hereby vacated and remanded for further proceedings consistent with the opinion of this Court.

Attest:

/s/ THOMAS F. QUINN
Clerk

November 20, 1975